

GAO

Report to the Chairman, Subcommittee on Oversight and Investigations, Committee on Energy and Commerce  
House of Representatives

October 1986

# ADP ACQUISITION

## SEC Needs to Resolve Key Issues Before Proceeding With Its EDGAR System



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United States  
General Accounting Office  
Washington, D.C. 20548

Information Management and  
Technology Division

B-222177

October 9, 1986

The Honorable John Dingell  
Chairman, Subcommittee on  
Oversight and Investigations  
Committee on Energy and Commerce  
House of Representatives

Dear Mr. Chairman:

This report is in response to your October 1, 1985, request that we evaluate, monitor, and conduct a complete evaluation of the Securities and Exchange Commission's (SEC) Electronic Data Gathering, Analysis and Retrieval (EDGAR) project. In discussing the results of our review with your representatives, we noted particular concerns that the SEC and potential vendors should consider prior to award of a contract for the operational EDGAR system. As a result, we agreed to report the results of our work in two stages. This initial report raises specific issues regarding the SEC's decision to proceed with acquisition of the operational EDGAR system at this time.

As arranged with your office, unless you publicly announce the contents of this report, we plan no further distribution of the report until 30 days from its issue date. We will then send copies to the Chairmen, Senate and House Committees on Appropriations, House Committee on Government Operations, and Senate Committee on Governmental Affairs; Director of the Office of Management and Budget; and other interested parties; and will make copies available to others upon request.

Sincerely yours,

Warren G. Reed  
Director

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# Executive Summary

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## Purpose

The Securities and Exchange Commission protects the investing public by providing for full disclosure of companies' business and financial information. To accomplish its mission, the Commission receives hundreds of thousands of paper filings—disclosure statements and reports—a year. In 1984 the Commission awarded a contract for the development of a pilot “paperless” filing and processing system known as EDGAR (Electronic Data Gathering, Analysis and Retrieval). Concerned whether EDGAR would meet its original goals, the Chairman, Subcommittee on Oversight and Investigations, House Energy and Commerce Committee, requested that GAO evaluate EDGAR at the end of the pilot. This report responds to a portion of the request: whether the Commission is ready to proceed with an operational system.

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## Background

The purpose of EDGAR is to (1) provide investors, securities analysts, and the public with instant access to corporate filings for more informed investment decisions; (2) allow companies to file electronically, generally using their existing equipment; and (3) allow Commission staff to process and analyze filings more efficiently by using computers.

Since research indicated that developing such a system would be complex, the Commission decided to test its feasibility with a pilot system. A contractor developed the pilot from April 1984 to April 1986, during which time over 300 volunteer filers submitted about 5,700 filings. Based on pilot results, the Commission decided to proceed with development of an operational EDGAR system and issued a request for proposals in May 1986.

The operational system, as planned, would consist of two separate computer systems—one system for internal Commission processing, and one external system to electronically receive and disseminate filings submitted annually by over 13,000 filers. The Commission proposes to fund the estimated \$35-million cost of the internal system using appropriated funds. The external system is to be financed by a contractor who recovers the cost, and a reasonable rate of return, by charging users for data filed with the Commission. Responses to the request for proposals were originally due by September 10, 1986, but have now been extended to December 31, 1986, with contract award within 120 days.

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## Results in Brief

The Commission's goals for EDGAR are noteworthy, and the pilot showed the Commission could receive, analyze, and disseminate filings electronically. However, the operational system will be a much more complex

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undertaking because the number of filers and filings will increase substantially, new functions will be automated, and online access will be expanded for both Commission and public use. Some significant issues need resolution before the Commission proceeds. These are:

- clearer identification of the extent of filer opposition to, and exemption from, the electronic filing procedures and formats the Commission plans to mandate for the filing community;
- the Commission's decision, contrary to existing law and public policy, to finance the receipt portion of the system through user fees rather than with appropriated funds; and
- the need to better determine total costs and quantitative benefits and to more adequately describe the qualitative benefits of EDGAR.

Because EDGAR is complex and will significantly change the collection, review, and disclosure of the nation's financial investment information, the Commission and the Congress need to be sure that their multi-million-dollar investment is sound, properly justified, and financed in accordance with existing law. GAO believes these issues should be resolved before proceeding with award of a contract for the operational system.

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## Principal Findings

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### Extent of Filer Acceptance

To achieve the full benefits envisioned for the operational EDGAR system, the Commission must, and plans to, impose special reporting requirements on filers. These include mandating, with some exemptions, that all filers submit their filings and all exhibits to filings electronically and that financial data be submitted in a Commission-specified format. On June 26, 1986, the Commission initiated the rulemaking process to obtain public comments on these reporting requirements. While some initial public reaction has been received, completion of this process is not envisioned until spring 1987. As a result, the Commission will not know the extent to which filer opposition to and exemption from these requirements may be justified, and thus limit their implementation. Nor does it know the final criteria for granting exemptions. The degree to which exemptions are granted could affect the Commission's ability to achieve EDGAR benefits, such as staff-year savings, and the contractor's ability to recover external system costs. (See pp. 18 to 23.)

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**Financing Receipt of Filings**

The Commission's financing approach for the operational EDGAR system will result in the contractor's recovering, through user fees, the cost of developing and operating the receipt portion of the system. According to existing law and federal policy intended to ensure that fees or charges for government information are reasonable, a fee for furnishing information is limited to no more than the cost of providing the information, plus a reasonable allowance for profit when provided by a contractor. GAO believes the receipt portion is an integral part of the Commission's internal data processing requirements. Therefore, costs of the receipt portion should not be included in fees to users but should be financed through appropriated funds. (See pp. 24 through 28.)

Financing the receipt portion through user fees and the Commission's proposed fixed-price financing also limits congressional oversight and control since funding requests do not reflect the total cost of providing EDGAR internal processing capabilities. (See p. 29.)

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**Accuracy of Cost/Benefit Analysis**

The Commission's analysis of EDGAR costs does not include accurate hardware estimates or software development estimates that adequately consider the complexity of expanding EDGAR to, and developing new functions for, the operational system environment. Furthermore, estimates of quantitative benefits attributable to the internal system are based on assumptions that are neither economically feasible with today's technology, nor specifically attributable to EDGAR. As a result, the Commission's studies do not demonstrate that EDGAR's quantitative benefits will be greater than its estimated cost. The Commission believes that sufficient qualitative benefits will accrue to filers, the investing public, and itself to justify the development of the system regardless of the quantitative benefits shown. However, its studies do not describe how qualitative benefits accrue, what form they take, or precisely who receives them.

GAO questions the advisability of proceeding with the implementation of a system as complex and far-reaching as EDGAR without the benefit of better estimates of costs and quantitative benefits and an adequate description of qualitative benefits. This information will provide the Commission and the Congress added insurance that they are making an informed decision on development and funding of EDGAR. (See chap. 4.)

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## Recommendations

GAO recommends that the Chairman of the Commission resolve the issues involving the extent of filer acceptance, the financing approach for receipt of filings, and the adequacy of cost/benefit analyses before awarding a contract for the operational system. GAO also recommends that the Congress satisfy itself that the Commission has adequately responded to issues raised in this report before providing funding for the operational system. (See p. 41.)

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## Agency Comments

The Commission generally disagreed with the report's findings, conclusions, and recommendations. In its comments, the Commission states that it has obtained sufficient filer comment; that existing law does not require government functions to be fully financed by appropriated funds; and that the primary justification for EDGAR is benefits to investors, filers, and the economy—not internal benefits to the Commission. However, in considering the Commission's comments, GAO found that it

- obtained only limited filer comments on proposed electronic filing requirements prior to issuing the request for proposals, and comments received in response to the rulemaking process indicate that many filers oppose these requirements;
- did not properly interpret the User Charge Law when it concluded that receipt system costs can be included in the cost base used to establish charges for dissemination; and
- has yet to prepare a comprehensive cost/benefit analysis to support proceeding with the operational EDGAR system. (See chap. 5 and app. II.)

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**Abbreviations**

EDGAR	Electronic Data Gathering, Analysis and Retrieval
FOIA	Freedom of Information Act
GAO	General Accounting Office
IBM	International Business Machines Corporation
OMB	Office of Management and Budget
SEC	Securities and Exchange Commission
SNAP/SHOT	Systems Network Analysis Program/Simulated Host Overview Technique
RFP	request for proposals

# Introduction

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Created in 1934, the Securities and Exchange Commission (the Commission) administers a group of statutes in the area of securities and finance, including the Securities Act of 1933, the Securities Exchange Act of 1934, the Public Utilities Holding Company Act of 1935, the Investment Company Act of 1940, and the Investment Advisers Act of 1940. In general, these statutes seek to protect the investing public by

- providing for full disclosure of material business and financial information by companies issuing securities or with securities listed on exchanges,
- regulating the nation's securities markets, and
- preventing and policing fraud and malpractice in the securities and financial markets.

In recent years, the Commission has received an increasing number of disclosure statements and reports—"filings"—that it must review to meet its statutory requirements. From calendar years 1977 to 1983, the securities industry grew rapidly; the number of shares traded on the New York Stock Exchange increased over 300 percent from 5.2 billion in 1977 to 21.6 billion in 1983. Correspondingly, between fiscal years 1977 and 1983, there was a 260 percent increase in first-time registrants (those companies initially registering with the Commission before offering their securities to the public as required by the Securities Act of 1933).

In 1983, faced with this enormous influx, which totaled some 5.4 million pages in 1982, the Commission's Chairman initiated a long-range program to upgrade the Commission's data processing capabilities. As part of the overall program, a task force explored the possibility of a "paperless" filing and processing system. The Commission consulted many sources to determine the best use of automatic data processing to make available to the public information disclosed in documents filed with the Commission, and to manage information internally for compliance with securities laws. As a result of this effort, in May 1984, the Commission competitively awarded a 2-year contract to develop a pilot system for EDGAR (Electronic Data Gathering, Analysis and Retrieval).

In March 1985, we testified before the Subcommittee on Oversight and Investigations, House Energy and Commerce Committee,<sup>1</sup> noting deficiencies in the Commission's development, procurement, and implementation of the EDGAR pilot system. After these hearings, the Subcommittee was concerned that EDGAR would not meet its original goals within the time and budget limits proposed by the Commission. Therefore, on October 1, 1985, the Subcommittee Chairman requested that we conduct a complete audit of the EDGAR system (see appendix I).

This report responds to the Subcommittee's request to determine whether the Commission is ready to proceed with development of an operational EDGAR system. We will issue an additional report to respond to other Subcommittee concerns.

## Commission Filing Requirements

In general, federal securities laws require companies offering securities to the public, those with securities listed on a national securities exchange, and others to disclose material business and financial information for use by investors. Disclosures are made by filing registrations, proxy statements, and other periodic and annual reports with the Commission. For example, the Securities Act of 1933 requires companies to file registration statements before offering their securities to the public. The basic registration form used for this purpose requires data such as a description of the offering, the offering price, the use of proceeds, and the registrant's business, as well as other information.

As another example of disclosure filing requirements, the Securities Exchange Act of 1934 requires all companies whose securities are registered on a national securities exchange, and other companies meeting certain criteria, to register such securities with the Commission. This registration establishes a public file containing material financial and business information on the company for use by investors and others, and creates an obligation on the part of the company to keep such information current by filing other periodic reports. The general form used to register securities requires a description of the registrant's business, properties, directors and executive officers, market price of and dividends on the registrant's common equity, financial statements, and so forth. Also under this act, companies are required to file an annual report that provides a comprehensive overview of the registrant's state

<sup>1</sup>Statement of James R. Watts, Senior Group Director, Information Management and Technology Division, General Accounting Office, on the Securities and Exchange Commission's Electronic Data Gathering, Analysis and Retrieval (EDGAR) System, March 14, 1985.

of business; annual reports are due 90 days after the close of the company's fiscal year.

The filing process for required forms generally consists of companies delivering multiple copies of paper documents to the Commission. The EDGAR program is designed to automate the filing, processing, and dissemination of these documents. In fiscal year 1985, the actual number of forms and amendments to these forms received by the Commission totaled 359,790. Of these, the Commission estimates that 241, 816, or 67 percent, would be applicable to the planned operational EDGAR system. It projects an annual growth rate of 10 percent for these documents.

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## The Acceptance and Review Process

Currently, the Commission's Office of Applications and Reports Services receives paper filings and verifies that: the correct number of copies are received, authorized signatures are present, any required filing fees have been paid, and the filing format is correct. Filings that pass this acceptance process are made available to the public in the Commission's public reference rooms. They are also distributed to the appropriate Commission division for review and to a contractor that prepares microfiche copies. Filings not passing acceptance processing may be suspended (until problems are resolved) or rejected (which requires the filer to refile).

Once received by the divisions, some filings are subject to an initial review process using preestablished, selective review criteria to identify filings where examination by the staff is most warranted. The criteria used in this process are derived from a variety of sources and are varied in response to changing securities markets, financing techniques, public concerns, and economic conditions. For example, in the Division of Corporation Finance, senior staff screen some filings to identify companies having financial difficulties (as indicated by unfavorable financial ratios). To do this, they access an external data base that lists those companies not meeting certain preestablished financial ratios. In addition, other filings may receive a full review simply because of the nature of the filing. For example, registration statements pursuant to the Securities Act of 1933 generally receive a full review if they are a company's first filing with the Commission.

Full disclosure reviews performed by the Division of Corporation Finance focus on ensuring that filings comply with disclosure requirements as required by the applicable laws; this provides investors with material information and helps to prevent fraud and misrepresentation

in the public trading, voting, and sale of securities. Similarly, the Division of Investment Management performs disclosure reviews to ensure that investment companies' and investment advisers' policies and procedures are clearly described and that their proposed activities comply with the law.

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## Purpose of EDGAR

Because of the growing volume of filings and the desire to take advantage of the most current information-processing and communications technology and to improve dissemination of information, the Commission began the EDGAR program to test the feasibility of electronic filing and processing. The Commission's purposes are to:

- provide investors, securities analysts, and the public with instant access to corporate disclosure documents, to make more informed investment decisions possible;
- allow companies to make required filings electronically generally using their existing equipment; and
- allow Commission staff to process and analyze filings more efficiently through computers.

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## Overview of the EDGAR Pilot Program

Preliminary Commission research indicated that an electronic filing system would be a complex undertaking. The Commission decided that a pilot system would provide the Commission and filers the opportunity to gain experience and to test various approaches with different types of computer hardware and software. On April 30, 1984, the Commission awarded a 2-year, \$7.5-million, cost-plus-fixed-fee contract for development of a pilot system to Arthur Andersen and Company, with International Business Machines Corporation (IBM) as subcontractor. In addition to the pilot system team, the Mitre Corporation provided technical assistance to the Commission for the design and evaluation of the pilot.

On April 30, 1986, this original contract with the pilot contractor expired. Final contract cost including modifications for additional work and contract extensions and for buy-out costs of automatic data processing equipment totaled about \$10.8 million.<sup>2</sup> The pilot contractor will continue to operate and maintain the pilot system for an estimated cost of \$1.3 million for fiscal year 1986, and about \$260,000 per month thereafter until a contractor is selected for the operational EDGAR system.

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<sup>2</sup>Total contract cost through contract modification 0029, signed August 13, 1986.

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## Processing and Review of Filings

On September 24, 1984, the Commission received the first electronic filings. As contrasted with paper filing, the pilot system allowed the receipt of filings (1) by direct transmission over telephone lines; (2) on magnetic tape; and (3) on diskettes prepared on over 85 types of word processing equipment.

After electronic receipt of filings, employees in the Office of Applications and Reports Services use EDGAR workstations to perform acceptance processing similar to that for paper filings. Once accepted, filings are available for screening at EDGAR workstations by examiners (in a special branch in the Division of Corporation Finance) using the same selective review criteria as for paper filings. If further review is required after screening, it is done by examiners on the EDGAR workstation.

The Division of Investment Management began processing electronic filings by public utility holding companies in July 1985 and by investment companies in November 1985. Similar to the approach for other electronic filings, filings for these companies are processed and reviewed at EDGAR workstations having the same capabilities as those of the Division of Corporation Finance.

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## Pilot EDGAR Functions

The EDGAR pilot had three phases. Phase I provided for receipt and limited processing of electronic filings. Phases II and III added enhancements to processing and tested additional hardware and software. The following functions, among others, were performed in the pilot.

- Receipt of participants' filings electronically (either by direct transmission, magnetic tape, or diskette).
- Retrieval, review, and annotation of filings by examiners on EDGAR workstations.
- Accessing external data bases such as Dow Jones News Retrieval Service.
- Use of a formatted screen of financial data to assist in the review process.
- Searches of the EDGAR data base to locate filers or filings or to identify documents containing a key word or phrase.
- Use of electronic file folders to store and to transfer work papers related to the review of a filing.
- Use of electronic mail to notify filers of filing acceptance and to send them comment letters.

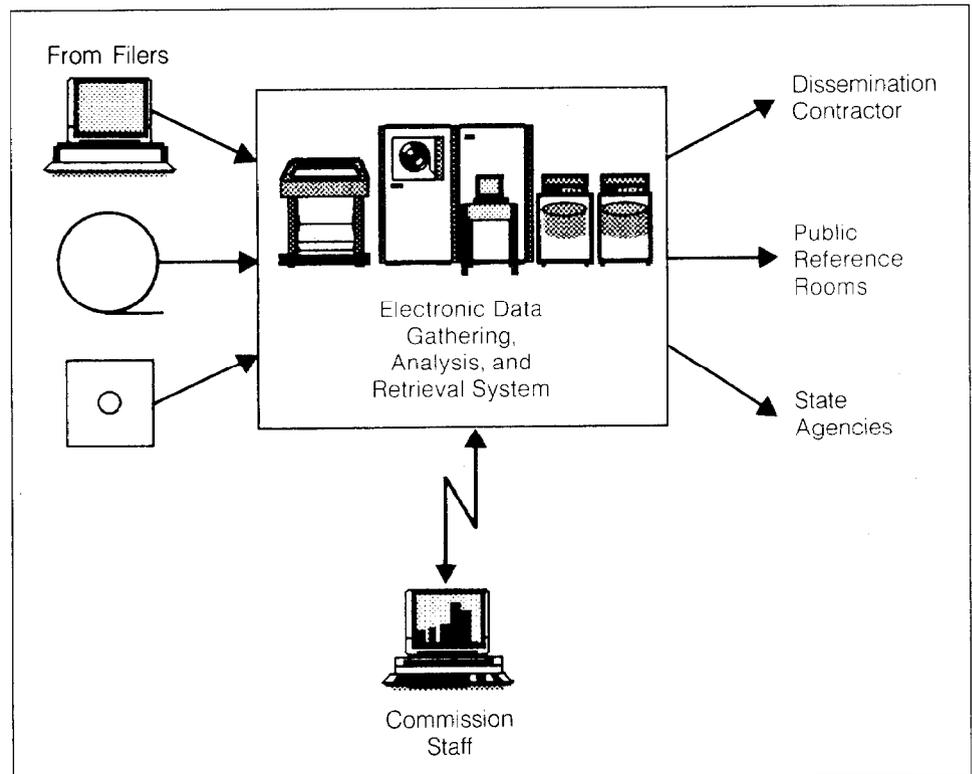
## Dissemination Activities

The Commission did not undertake total electronic dissemination to the public during the pilot. Instead, it limited dissemination to making EDGAR filings available at terminals in its public reference rooms in Washington, D.C., New York, and Chicago. The pilot also generated computer output tape for the Commission's dissemination contractor, Bechtel Information Services, to produce microfiche.

In addition, the Commission experimented with the possibility of a single filing with the Commission constituting the filing required by state laws. As part of this experiment, the Commission provided access to public filings in the EDGAR data base to three states: California, Georgia, and Wisconsin.

The pilot system process, as described above, is illustrated in figure 1.1.

Figure 1.1: EDGAR Pilot System Architecture



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## The Proposed Operational System

On May 7, 1986, the Commission issued a request for proposals (RFP) for development of the operational EDGAR system that will process data for the Corporation Finance and Investment Management Divisions. The RFP required that offers be submitted by September 10, 1986, with contract award to take place within 120 days of that date; but on September 3rd, the Commission announced an extension of the offer submission date to December 31, 1986.<sup>3</sup>

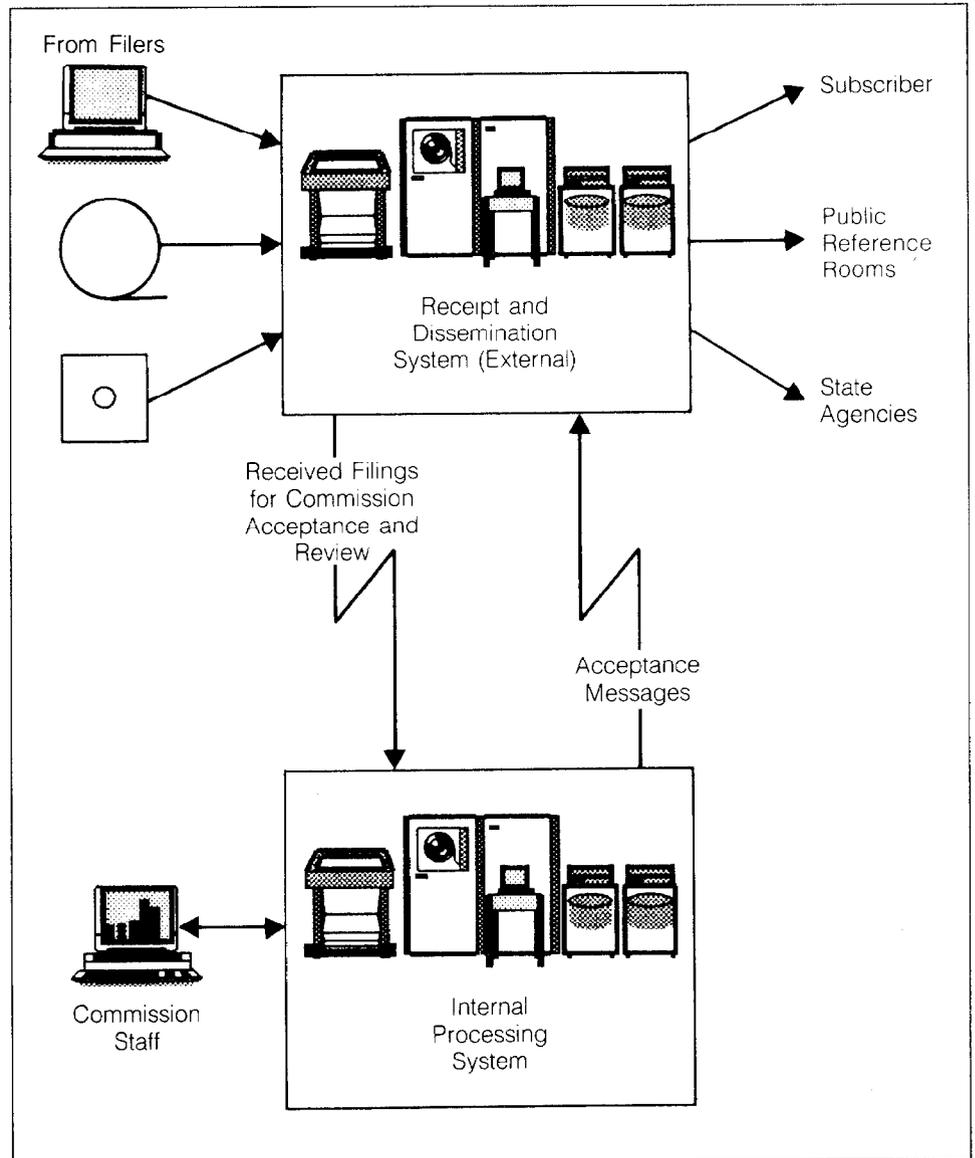
According to the original May 7, 1986, RFP, the contractor is to furnish and maintain at least two separate automated systems: an "internal system" for internal Commission processing of filings, and an "external system" or "receipt and dissemination system" for the electronic receipt of such information and dissemination of this information to the public.

In the proposed operational EDGAR environment, companies send their filings electronically by direct transmission to the external system operated by the contractor. Magnetic tapes and diskettes would also be converted and input to the external system. Filings received would be transmitted to the Commission's internal system via an encrypted link for its internal processing and review. The contractor would later receive an acceptance message from the Commission, and then disseminate the filings to the Commission's public reference rooms, state securities administrators, and subscribers to filing information. The Commission's hypothetical architecture for the operational system, as described in the original RFP, is illustrated in figure 1.2.

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<sup>3</sup>According to the Commission, the extension is to consider comments received from potential bidders and others. Changes being considered include (1) the possibility of scheduling payments to coincide more closely with the contractor's expenditures, (2) permitting shared or dedicated off-site facilities, and (3) extending the 7-year term of the contract. Any changes in the RFP are to be published by October 31, 1986.

Figure 1.2: Commission's Hypothetical Architecture for the Operational EDGAR System



## Objectives, Scope, and Methodology

Concerned that EDGAR will not meet its original program goals within the Commission's proposed time and budget limits, the Chairman of the Subcommittee on Oversight and Investigations, House Committee on Energy and Commerce, requested that we evaluate, monitor, and conduct a complete review of the EDGAR system, including its procurement and implementation, at the conclusion of the pilot program.

In discussing the results of our review with Subcommittee staff at the completion of our work, we noted particular concerns that we believe the Commission and potential vendors should consider prior to award of the contract for the operational system. These include unresolved policy issues for EDGAR implementation, the appropriateness of the proposed financing approach for the operational system, and the reasonableness of cost/benefit estimates. As a result, the Subcommittee requested that we issue an initial report that would highlight these specific concerns prior to the close of the RFP period.

We also agreed to issue a subsequent report to respond to specific Subcommittee concerns regarding the actual capabilities of the pilot system, and the procurement practices and overall management of the pilot project.

We conducted our review at the Commission's headquarters in Washington, D.C., from November 1985 to June 1986. We interviewed Commission officials and EDGAR program staff in the Office of the Executive Director, the Corporation Finance and Investment Management Divisions, and the Office of Applications and Reports Services. We also interviewed key EDGAR project staff from Arthur Andersen and Company and the Mitre Corporation.

We reviewed the RFP for the operational system to determine the functional requirements for the system, the proposed financing approach, and other specific provisions relating to contractor cost recovery and incorporation of new technology.

In reviewing the Commission's proposed financing approach for the operational system, we analyzed Comptroller General decisions cited by the Commission in their funding analysis as precedents for recovery of system development and operating costs through user charges. We also analyzed provisions of the Freedom of Information Act (5 U.S.C. §552) and the User Charge Law (31 U.S.C. §9701) as they pertain to setting fees for providing information to the public.

To determine the functions in operation for the pilot system, we observed EDGAR project staff receiving and reviewing filings, reviewed EDGAR user manuals for the divisions and the Office of Applications and Reports Services, and participated in formal Commission training on EDGAR workstation functions available through the end of the pilot development contract. We also analyzed evaluation reports on the pilot

system prepared by the Mitre Corporation and by Arthur Andersen and Company.

We reviewed cost/benefit analyses for the internal EDGAR system prepared by the Commission and its Office of Internal Audit. We analyzed these analyses' methodology and assumptions for estimating cost and for identifying and quantifying benefits attributable to the system. We interviewed Commission staff who prepared these analyses and obtained supporting documentation for their estimates of quantitative EDGAR benefits.

In justifying development of the operational EDGAR system, cost/benefit analyses and Commission officials cite qualitative benefits both internal and external to the Commission. Because of their limited treatment in these analyses, we did not evaluate such benefits as part of our review.

# Issues Critical to EDGAR Success May Not Be Resolved Prior to Contract Award

The Commission has not determined the extent to which filers will oppose electronic filing requirements that the Commission plans to mandate upon them. The Commission plans—with some exemption criteria yet to be determined—to require all filers to file all material electronically and certain financial data in a specified format. In planning for EDGAR and in estimating its benefits, the Commission assumed that all filings would be submitted electronically; it also assumed that financial data could be readily identified in EDGAR to more quickly and effectively select filings for review. However, despite the critical nature of these requirements to EDGAR benefits, the Commission did not obtain comprehensive, formal filer comments to determine the extent to which filers may be capable of or receptive to electronic filing. The Commission initiated the formal rulemaking process to obtain public comment, but that may not be completed during contract negotiations. Therefore, the Commission has decided to proceed with the procurement of the operational system without knowing the extent to which the benefits it envisions for the system can be realized. Furthermore, filer exemptions and limitations of other proposed requirements could result in an incomplete data base, which may be less marketable and may limit the contractor's ability to recover costs.

## EDGAR Benefits Are Dependent on Changing the Filing Process

The purpose of EDGAR is to receive filings electronically, allowing the Commission to process and analyze filings more efficiently at computer workstations and providing the public and others with improved access to corporate disclosure documents. To achieve and maximize these potential benefits, EDGAR must receive essentially all filing material in an electronic format. Therefore, to help obtain this complete data base of filings, the Commission anticipates requiring all of its some 13,000 filers to change from filing on paper to electronic filing, with some exemptions for hardship. In addition, to help automate the review process, the Commission plans to require filers to submit electronically an additional financial data sheet that identifies or "tags" this data for the EDGAR system.

## Mandated Electronic Filing

Commission officials believe that mandating electronic filing is critical to the success of EDGAR. Their estimates of staff-year savings for improved efficiency of processing and reviewing filings assume complete phase-in of electronic filing for all filers handled by the Divisions of Corporation Finance and Investment Management. If all filings are not received electronically, then the Commission must retain portions of its manual processes. This reduces the benefits envisioned.

or filing an additional financial data sheet. Instead, the Commission relied primarily on comments from participants in the EDGAR pilot project and other informal feedback. Based on these sources, Commission officials believe that filer resistance to additional requirements will not have a great impact. Comments to the Commission by participating filers showed general acceptance of electronic filing; but we noted that comments from some participants and by the Information Industry Association<sup>5</sup> question whether companies can afford the start-up costs for converting to electronic filing. Commission officials reaffirmed the agency's commitment to mandating electronic filing, but allow that it is more a question of the degree of exemption to be granted to this requirement. They acknowledge that the degree of exemption granted could affect the completeness of the EDGAR data base.

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## Timing of Rulemaking Limits Its Usefulness

The Commission believes that under existing securities laws it has the authority to change filer requirements. To obtain comments on the proposed changes, on June 26, 1986, the Commission released an advance notice of proposed rulemaking (published July 2, 1986, in the Federal Register). However, this notice was not issued until after the RFP's release; and the final results of the rulemaking process will not be known during negotiations on the operational system contract. Moreover, the degree of filer opposition to proposed electronic filing requirements and the criteria for granting exemptions, and their impact on operational system requirements success, may not be known until after contract award.

Comments were due on the advance notice of rulemaking by September 5, 1986, just 5 days before proposals for the operational EDGAR system were originally due. According to the Commission official overseeing the rulemaking process, after considering these comments the Commission will issue a notice of proposed rulemaking, allowing another 60-to-90-day comment period. The Commission anticipates final rulemaking in spring 1987, but if it decides to extend the comment period or provide an opportunity for oral arguments, the time required to finalize rulemaking could be further increased.

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<sup>5</sup>This trade association, founded in 1968, represents nearly 460 information publishers and information services organizations. These companies collect, create, store, analyze, manage, and distribute information both electronically and on paper.

Commission not to use artificial intelligence for the operational system for now.

The Commission also experimented with filers' tagging data as part of their submissions. In the EDGAR pilot, 30 of the 178 pilot filers for the Corporation Finance Division voluntarily provided an additional, formatted submission with their annual and quarterly filings. EDGAR then identified specific data needed to calculate some 15 different operating and financial policy and credit policy ratios. Although this approach received limited testing in the pilot, it provided a means for the pilot system to identify financial data for calculating ratios. As a result, the Commission has required offerors for the operational system contract to include at least one approach to the data tagging problem. Regardless of the final approach, the Commission plans to require filers to tag data in their filings to enable EDGAR to automate the Commission's review process. The extent to which the Commission achieves projected staff-year savings is, in part, dependent on the Commission's success in imposing the additional schedule on the filers.

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## RFP Issued Before Comments Were Obtained

Despite experience in the EDGAR pilot that not all filers would be receptive to or able to file electronically, the Commission did not formally seek comments from the filer population before releasing the RFP for the operational system. The Commission does not know the extent of opposition to or exemptions from these requirements or their impact on future filing volumes for offerors to consider in preparing proposals.

Response to the EDGAR pilot project did not indicate that all filers are able to file electronically or that they support this change. For example, according to a Commission official, the Commission sent out questionnaires to as many as 11,000 filers, requesting volunteers for the EDGAR pilot project. Of the some 400 filers responding, the Commission determined that 145, or 36 percent, were actually prepared to file electronically at the beginning of the pilot. Our review of questionnaire responses showed companies choosing not to participate in the pilot for reasons including limited technical capability, the additional cost of electronic filing, and no desire to participate in a pilot when an operational system may be different. Another Commission official added that some companies chose not to participate because they did not want the added review that pilot filers would receive.

Commission officials said that they have not conducted any comprehensive, formal survey of filers on such issues as mandated electronic filing

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handle these documents during their review process. For example, information in a company's annual report to security holders may be incorporated into some filings. The annual report is generally not prepared in electronic format and may contain pictures, graphs, and other image material. In the pilot, the annual report was submitted on paper, either filed as an exhibit to a filing or provided to the Commission for information purposes (if not incorporated by reference). For the operational system, the Commission could require that filers submit in an electronic format all material incorporated by reference including information from documents that cannot be filed electronically, such as some annual reports to security holders. This information could be filed as part of a filing or as a separate submission. In addition, the Commission is also considering whether, at some time in the future, the ability to incorporate by reference exhibits previously filed on paper should be discontinued.

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### Special Reporting Formats for Financial Data

The Commission's projected staff-year savings are also dependent on automating processes that the Commission currently performs manually. One such process is the calculation of financial ratios for selecting filings for review. However, to fully automate this process EDGAR has to identify this data itself or have data identified for it.

During the pilot, the Commission experimented with solutions to the "data tagging" problem, a generic term the Commission uses to refer to alternative approaches to identifying, extracting, and manipulating information contained in filings. Because the Commission did not want to impose any special reporting requirements upon filers, it initially explored the approach of having the computer search a filing, locate and identify specific types of financial data, and calculate ratios through use of artificial intelligence.<sup>4</sup> The pilot system contractor conducted an experiment, known as the Financial Statement Analyzer, on a special-purpose computer. This appeared to work well, but the computer programs developed to run on this specialized computer are not readily translatable to a language usable on the EDGAR pilot mainframe computer. In addition, linking the special-purpose and mainframe computers is difficult because they had different manufacturers and have limited compatibility. Translating the special artificial-intelligence programs or linking the two systems would result in reduced processing efficiency and system maintenance ability. These technical limitations caused the

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<sup>4</sup>This term describes the use of computers to perform operations analogous to the human abilities of learning and decisionmaking.

Provisions of the current RFP also call for the contractor to recover the costs of developing the receipt and dissemination portions of the operational EDGAR system, plus a reasonable rate of return through regulated charges to users of filed information. The Commission and prospective contractors note that the amount users are willing to pay—and, thus, the ability of the operational system contractor to recover costs and earn a return—depends on the completeness of the EDGAR data base.

The Commission recognizes that there may be circumstances where electronic filing could be unduly burdensome. Therefore, it anticipates proposing a hardship exemption that would permit filing on paper. Through the rulemaking process, the Commission is seeking comments on the conditions that may warrant an exemption, such as lack of equipment capable of making an electronic filing and inability to obtain the services of an agent such as a financial printer. In addition, comments have been also sought on whether the exemption should be granted on a filing-by-filing basis or for a specific period of time, as well as whether there should be any categorical exemption based on a filer's size.

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### Exhibits and References to Previously Filed Material to Be Filed Electronically

Filing, processing, and reviewing efficiencies increase to the extent that a filing, its exhibits, or references to material in previously filed paper filings can be filed electronically. This reduces the need to physically process paper and the time to retrieve and review this material.

In the pilot project, material not cost effective to send electronically but accompanying a filing was sent on paper as an exhibit. According to a January 1986 Mitre Corporation report, early pilot experience showed that 45 percent of the pages of filing material submitted were on paper. This percentage later decreased with the Commission indicating that, in July 1986, about 12 percent of pilot filing material was submitted on paper. To make the electronic data base as complete as possible for the operational system, the Commission anticipates proposing that exhibits prepared after a filer is phased in to electronic filing must be submitted in an electronic format. Exhibits prepared prior to the time a filer is phased in could be filed on paper. However, the Commission also anticipates proposing a cutoff date several years after the beginning of the operational system, after which only exhibits filed electronically will be accepted.

In the pilot, filers could also reference previously filed paper documents in the electronic filing; this required the Commission staff to physically

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Commission officials stated that they decided to initiate the rulemaking process after the RFP's release because the RFP demonstrates a commitment to making EDGAR operational and, therefore, a need to require electronic filing. However, the rulemaking process provides a means to obtain public comment. If initiated during the pilot, comments indicating the potential degree of filer exemption and opposition to other proposed requirements would have been available for consideration in preparing the operational RFP and awarding the operational system contract. With the RFP now extended to December 31, 1986, the Commission has the opportunity to at least consider comments received in response to the advance notice of proposed rulemaking and to make revisions, as appropriate, to system requirements indicated in the RFP.

# Financing Approach Is Inconsistent With Existing Law and Limits Congressional Oversight

Contrary to existing law and public policy, the Commission proposes to finance costs of developing and operating the receipt portion of the EDGAR system through user fees. Current law and federal policy state that fees assessed requesters of publicly available information must be based only on the actual cost of providing the information. Hence, costs for creating, collecting (receiving), processing, and transmitting data may not be recovered by the fee. Consequently, these costs are to be borne by agencies and funded through congressional appropriations. We believe the receipt portion of the EDGAR system is clearly designed to support and handle the functions of collecting and accepting information from filers; these functions would be performed whether or not the public requested any of the information. Accordingly, the receipt portion should be considered part of the internal system, and its cost funded by appropriations, rather than included in the cost base used to establish regulated user fees.

The Commission's proposal to recover internal processing costs through fees charged the public also bypasses the authorization and appropriation process to some degree and limits congressional oversight. In addition to receipt system costs, the Commission's approach allows for costs exceeding the proposed \$35-million appropriation for other portions of the internal system to be recovered by the contractor. This the contractor would do through non-regulated sales of filing information not required by law to be disseminated to the public. As a result, the total cost of providing EDGAR capabilities for the Commission's internal needs have not been reflected in appropriation requests for the system. The proposed financing approach is not consistent with existing law, and making it consistent will necessitate changes to the RFP and an increase in appropriations. At the time of our review, the Congress had neither authorized development of the operational system nor approved appropriations.

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## The Commission's Proposed Financing Approach

The Commission proposes to fund the internal system through fixed-price payments not to exceed \$5 million annually, or \$35 million for the life of the contract, subject to annual congressional appropriations. The Commission proposes to finance EDGAR's external system by allowing the contractor to recover system development and operating costs plus a reasonable rate of return through fees charged for obtaining filing information. This dissemination is part of the Commission's mission of making filing information available to the public; it includes two mandatory, minimum levels of service for which fees charged will be regulated

by the Commission. Level I service is subscription service to all Commission filings either by daily, overnight delivery of filings to subscribers via magnetic tape or, at the subscriber's option, real time on-demand access to specifically requested filings. Level II service is a subscription service to one or more of eight Commission-specified subsets of the entire data base, such as periodic filings of companies on the New York Stock Exchange or Securities Act of 1933 registration statements. The contractor must provide Level II service on a daily basis, with overnight delivery of magnetic tape. In addition to these required services, the contractor may manipulate filing information to enhance its usefulness as it chooses, and then sell the enhanced data to the public. The Commission will not regulate pricing of enhanced data because it believes that other Level I subscribers can provide these "value added" services and thus provide direct competition to control pricing.

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## Cost Recovery Through Fees Charged Is Limited

Originally, the Commission considered the contractor developing and operating both the internal and external systems of the operational EDGAR system at no cost to the government. But, in response to congressional concern and contractor comments indicating reluctance to risk such a large capital investment, the Commission changed its financing approach to pay for up to \$35 million of the internal system's cost with its funds. However, it still proposes to recover some internal system costs through fees charged subscribers by the operational system contractor.

We reviewed the Commission's funding analysis and existing laws on fees charged for furnishing information to the public and determined that under the Freedom of Information Act (FOIA) and the User Charge Law an agency can charge no more than the cost of providing a copy of the information. For example, under the Freedom of Information Act, the government must, with limited exceptions, make agency records available to public requesters, and may recover only reasonable, standard, and direct charges for document searches and duplication. Additionally, when the User Charge Law applies, the courts and our previous report<sup>6</sup> have determined that fees assessed by the government for providing a special, identifiable benefit or service must be based on

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<sup>6</sup>Electronic Industries Association, Consumer Electronics Group v. Federal Communications Commission, 554 F.2d 1109, 1117 (D.C. Cir. 1976) and National Association of Broadcasters v. Federal Communications Commission, 554 F.2d 1118, 1133 (D.C. Cir. 1976). See also our report, Establishing a Proper Fee Schedule Under the Independent Offices Appropriation Act, 1952 (CED 77-70, May 6, 1977).

the actual cost (direct and/or indirect) of providing the benefit or service, and may not include costs incurred primarily to serve general public interests.

These provisions deny the Commission authorization to include costs of the internal EDGAR system in the cost base used to compute fees charged the public for information from the Commission. They are not direct costs related to search and duplication under the FOIA, and their inclusion would certainly raise a question about the reasonableness of the fee charged. Furthermore, these costs directly relate to serving a general public interest (i.e., meeting the Commission's internal needs) and, therefore, could not be recovered from the public under the User Charge Law.

A similar requirement is imposed on the Commission when assessing fees for copies of security registration statements to the public under section 6(d) of the Securities Act of 1933, as amended (15 U.S.C. 77f(d)). This provision provides that copies of security registration statements are to be furnished applicants at reasonable charges as prescribed by the Commission. Once again, it appears that the law contemplates only charging for costs related to copying the statement, and may not include costs related to meeting internal Commission needs.

In addition, we have held in previous decisions<sup>7</sup> that the costs for a service needed primarily for the agency's internal processing requirements may not be shifted to the public by interposing a no-cost contractor between the agency and the public user. Contractor costs not incurred as a direct result of providing copies of publicly available information should not be recouped through fees charged to a requester. Costs incurred in serving the Commission's internal data processing needs must be excluded from the cost base used to determine regulated fee amounts.

Consistent with the legal restrictions, Office of Management and Budget (OMB) policy states that internal processing costs should not be included in charges to users of government information. OMB states<sup>8</sup> that its circular on user charges<sup>9</sup> requires fees to cover costs for dissemination

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<sup>7</sup>See Matter of: Retention of Fees Received by EPA Contractors Providing Information Services to the Public, B-166506, October 20, 1975; and Matter of: Federal Election Commission, 61 Comp. Gen. 285 (1982).

<sup>8</sup>OMB Circular No. A-130, "Management of Information Resources," Section-by-Section Analysis (December 12, 1985).

<sup>9</sup>Circular No. A-25, "User Charges" (September 23, 1959).

only, not for creation, collection, processing, and transmission of government information.

## The Commission Should Pay for Developing and Operating the Receipt System

Although the Commission has proposed that the receipt function be part of the external EDGAR system to be financed through regulated fees, tasks performed for this function are more logically part of the internal processing system. The tasks currently performed by staff for both paper and electronic filings in the EDGAR pilot are necessary for the Commission's internal processing. Therefore, as stated above, the cost for developing and operating the receipt system should not be passed on to the public through user fees.

Commission staff perform similar processing steps for filings received in paper form and for filings received electronically in the EDGAR pilot. The Office of Applications and Reports Services physically receives paper filings, confirms that all copies are received, and performs acceptance processing to verify that filing fees (if any) have been paid, that authorized signatures are present, and that the filing is in the correct format. This office notifies filers who do not pass this receipt and acceptance processing. For accepted filings, this office routes copies to the public reference room for public access, to the appropriate division for review, and to the microfiche contractor for dissemination. Under the EDGAR pilot, volunteer companies send their filings to the Commission either by direct transmission over telephone lines or by delivery of magnetic diskettes or tapes for conversion and input to EDGAR. Office of Applications and Reports Services staff assist the filers in their transmissions, then use EDGAR workstations to check that filing fees are paid, to determine if filings are in the correct format, and to forward filings for review. Again, filers are notified if there is a transmission (receipt) problem or if the filing is not accepted. Accepted filings are available on EDGAR terminals in public reference rooms in Washington, D.C., New York, and Chicago. In addition, a computer output tape is provided the dissemination contractor to produce microfiche.

For the operational system, some of the receipt functions performed by Commission staff will shift to the contractor as part of the receipt portion of the external system. For example, the receipt system to be developed and operated by the contractor will have to receive all electronic filings (including those converted from tape and diskette). The receipt system will validate that all filings comply with submission requirements such as accurate page and document counts and valid passwords, and will post a notice on an electronic receipt and acceptance bulletin

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board for filers to check the status of their filings. Filings passing this receipt validation would go to the internal system for acceptance processing. Results of this acceptance processing (and additional processing by Commission staff) would be posted to the electronic bulletin board along with error messages for rejected filings. This bulletin board is considered part of the receipt system. The receipt system would store filings until accepted by the Commission, then add them to the internal system data base and contractor's dissemination data base.

Although the receipt system will include receipt tasks previously performed by staff, Commission officials do not believe that it is part of internal processing. They state that a primary purpose of EDGAR is to improve dissemination to the public, and electronic receipt is necessary to accomplish this purpose. Since many EDGAR functions (use of workstations to review filings, automated ratio calculation, and text searches) are also dependent on receiving filing data electronically, dissemination is not the only justification for electronic receipt.

The House Committee on Government Operations also considers the receipt system to be part of the Commission's internal processing requirements. This Committee's Subcommittee on Government Information, Justice and Agriculture held a series of hearings in 1985 on the subject of electronic collection and dissemination of information by federal agencies. A December 8, 1985, Subcommittee letter to the Commission and the Committee's April 1986 report<sup>10</sup> state that (1) the electronic receipt of filings is an integral feature of EDGAR necessary to support the internal processing of documents and (2) the cost of the receipt system should probably be borne by the Commission. In the report, the Committee discusses which costs of electronic information systems should be considered dissemination costs to be charged to outside users. The Committee concludes that the primary reason for undertaking EDGAR computerization is improving internal agency operations. Thus, the costs for computerization—hardware, software, and staff to obtain information and build an automated data base—should be borne by the agency; only the marginal cost of providing information service to the public can be charged public users, even if the dissemination system is operated by a contractor.

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<sup>10</sup>"Electronic Collection and Dissemination of Information by Federal Agencies: A Policy Overview," H. R. Report No. 99-560, 99th Cong., 2d Sess., 46 (1986).

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## Proposed Funding Approach Limits Congressional Oversight

In originally proposing that the entire operational EDGAR system be developed and operated at no cost to the government, the Commission acknowledged that non-appropriation-process funding limits congressional oversight. The Congress also recognized this reduction of its oversight role and indicated its intention to maintain oversight regardless of the funding approach used. Specifically, in its June 4, 1985, report on authorization of the Commission's fiscal year 1986 appropriation, the House Energy and Commerce Committee stated that the operational EDGAR system and its financing approach will be subject to approval through the authorization process. Even though the Commission has changed its proposed financing approach to fund the internal system through the appropriation process, it still intends to fund the receipt system's development and operational costs through dissemination fees. In addition, the Commission will limit its contribution for the current internal system to a fixed amount of \$35 million. Therefore, funding amounts will not include the total cost of providing EDGAR internal processing capabilities to the Commission, an issue of continuing concern to the Committee.

The Commission has requested congressional authorization and appropriations for the operational EDGAR system described in the current RFP; this it has done through correspondence, meetings, and hearings with congressional committees. However, funding for the development and operation of the system has not been approved, pending specific authorization. The authorization process by the House Energy and Commerce Committee specifically includes consideration of the Commission's proposed financing approach. The outcome of this process could change financing provisions in the RFP and the appropriation for the operational system.

# Commission Estimates of EDGAR Costs and Benefits Are Incomplete and Inaccurate

The Commission has not properly determined EDGAR costs and benefits for development of the internal portion of the operational system. Cost estimates are understated because

- they are based, in part, on an outdated computer model of the operational internal system (a more recent model indicates that a larger computer could cost some \$4.4 million more than the Commission's estimates over the life of the contract); and
- the operational internal system may require more software development than the Commission considered.

Furthermore, cost estimates for the internal system are incomplete because they do not include costs associated with the receipt function.

In addition to understating the operational internal system costs, the Commission has overstated the system's quantitative benefits. Commission estimates include benefits that are not attributable to EDGAR processes and that have been arbitrarily increased. As a result, neither the Commission nor the Congress has accurate and complete information to justify further development of the EDGAR system.

## Internal System Hardware Costs Are Underestimated

To estimate hardware costs of the internal system, the Commission used the results of a SNAP/SHOT<sup>11</sup> model run during the week of June 10, 1985. According to this model, at least one IBM 3081 computer would be needed for the internal system to process all Commission user transactions during a peak filing period (for example, the end of March when a certain report is due from nearly all filers). The Commission used the cost of this computer in August 1985 to estimate the cost of the internal system, and used this estimate in deriving the \$35-million funding request for the internal system and in analyzing its 7-year life cycle costs and benefits.

During the week of May 12, 1986 (only 5 days after the RFP issue date), the pilot system contractor ran another SNAP/SHOT model for the operational EDGAR system. According to contractor staff, this latest model is more accurate for the internal system than the first because user transactions used to simulate system operation include EDGAR functions added since the model was run nearly a year earlier. The latest model indicates

<sup>11</sup>Systems Network Analysis Program/Simulated Host Overview Technique (SNAP/SHOT) is an IBM modeling system.

that the Commission will need a 3090 computer to process all user transactions during a peak filing period. The IBM 3090-200 is nearly twice as powerful as the IBM 3081 the Commission used in developing its hardware cost estimates. The latest model also shows that (1) even this larger computer will use about 90 percent of its capacity during peak filing periods in 1988 and (2) utilization will eventually increase to 98 percent by 1991. The model predicts that a more powerful IBM 3090-400 computer will be needed by 1992. The IBM 3090-400 is over three times more powerful than the IBM 3081.

To estimate the potential cost implications of the revised estimate of computer hardware needs, we calculated the purchase price<sup>12</sup> of the IBM 3090-200 by comparing it to the actual amount included in the IBM 3081-version cost estimate. Our figures show that

- the 3090-200 purchase price would be \$4.1 million or \$0.6 million more than the \$3.5 million the Commission cites; and
- the purchase price for an upgrade from an IBM 3090-200 to a 3090-400 would be an additional \$3.8 million for a total of \$4.4 million more than the Commission's estimate.

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## Developmental Requirements Increase Potential of Additional Costs

The extent to which pilot-system software can be used in the operational system is unknown. The Commission undertook the pilot effort as a "concept evaluation," that is, to demonstrate the feasibility of electronic receipt of filings and other processing and review concepts. This pilot approach demonstrated the feasibility and, in the case of text searches, limitations of these concepts, but it did not produce a system readily usable in the proposed operational system environment with its higher filer volume and increased number of Commission users. As a result, the actual development work required for the operational system is uncertain, thus increasing the potential that development costs will exceed Commission estimates.

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## Concept Evaluation Approach

Under the EDGAR pilot concept evaluation, the contractor was to design a system to satisfy the functional requirements specified in the contract, test different approaches for providing these functions, and provide

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<sup>12</sup>Based on an August 26, 1986, IBM configuration output report that updates the General Services Administration's fiscal year 1986 authorized ADP Schedule Price List for IBM Equipment (contract no. GS 00K86AGS5557). Costs are for the central processing equipment alone and do not include cost of peripheral equipment or any maintenance charges.

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these functions to a sample group of users for use in the pilot environment with its limited number of filer participants. Using the concept evaluation, the Commission did not intend that the pilot become an operational system and therefore, did not formally verify that the pilot software is complete and accurate or that it meets user needs and requirements. Instead, the Commission relied on the Mitre Corporation to evaluate the different approaches being used by the pilot contractor and to offer alternatives for the operational system. The Commission also relied on user and filer comments to indicate problems and on the pilot contractor's normal systems development testing activities to ensure quality.

The concept evaluation may provide a system that operates successfully in the limited pilot environment. However, it limits the extent to which offerors can rely on development work done in the pilot, as indicated in comments received by the Commission from potential offerors for the operational system RFP. This limitation is reinforced in the RFP (which states that the use of the pilot hardware and software is optional). Therefore, potential offerors may not readily rely on pilot software or place the same value on this software as the Commission. An offeror could choose to develop new software, thus increasing development costs.

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## Operational System Environment

As another indication of the amount of development work yet to be performed in the operational system, the pilot system processed only a small percentage of filings received by the Corporation Finance and Investment Management Divisions. According to Commission statistics, the pilot system received 5,712 electronic filings from over 300 filers from September 24, 1984, to April 30, 1986. This is only 3 percent of the 192,289 filings received by the two divisions in fiscal year 1985 alone. In addition, the EDGAR pilot consisted of only 35 workstations. In the operational system, workstations will be increased to a proposed total of 448.

The pilot demonstrated that some approaches used may require modification or new development to satisfy the increased work load of the operational system environment. For example, the Commission experimented in the EDGAR pilot with the use of a commercially available software package with search capabilities. With this package, a user could identify all filings containing a keyword, say, "dividends," or those that contain both "dividends" and "shareholder" to include synonyms of these keywords such as "distributions" and "stockholders." This package provided an analytical tool for both the Commission staff and

users in the public reference rooms. However, experience in the pilot showed that response times for complex searches were poor and the amount of storage space needed could be excessive without careful monitoring. Therefore, the Commission concluded that this software package did not provide the best solution for the operational EDGAR environment. As a result, a new approach must be developed in the operational system to provide this particular search capability.

While this capability may be obtainable from another software package or by developing customized software, it remains a development item for the operational system, as it was in the pilot. The decision not to use this package for the operational system was not made until after the Commission's August 1985 estimate of internal system cost. Therefore, costs to develop a new text search approach are not reflected in that estimate.

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## Receipt Functions Not Part of Internal System Cost Estimates

Receipt functions are a logical part of the Commission's internal processing requirements, and their cost should be included in estimates of internal system cost and proposed funding amounts (see chapter 3). At the time of our review, the Commission had not specifically estimated the cost of the receipt portion of the operational EDGAR system. These costs could be significant considering the hardware requirements to perform receipt functions and new functions included in receipt system software that were not developed in the pilot.

As an indication of the additional hardware costs to be considered, the pilot contractor included a separate receipt/dissemination external system in the SNAP/SHOT model run in May 1986. This model, which incorporated receipt transactions and some limited dissemination via public reference rooms, showed that an IBM 3090-400 computer would be needed initially to handle peak work loads for the increased number of filers expected in the operational system environment. Additional computer hardware would be needed in the second or third year of the project. Our calculations show that the purchase price for this computer is approximately \$7.9 million. This cost would be additional to any hardware costs for the internal system given the Commission's proposed operational system configuration of separate internal and external systems. Therefore, estimates of internal system cost would have to include, at a minimum, the portion of hardware costs attributable to performing receipt functions.

In addition to estimating hardware costs for the internal system, the Commission must include the potential cost of developing new receipt functions not developed in the pilot. For example, the receipt portion of the operational system includes a new requirement for an electronic receipt and acceptance bulletin board to provide filers with immediate access to the status of their filings and error messages in the event filings have been rejected. This function was not developed for the pilot system, thus new software must be developed.

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### Commission Studies Do Not Accurately Show Internal System Costs and Benefits

Federal guidelines<sup>13</sup> recommend a cost/benefit analysis to provide adequate cost and benefit information for managers, users, designers, and auditors to analyze and evaluate alternative approaches, and for managers to make decisions on initiating or continuing the development, procurement, or modification of software or other automatic data processing-related services. The Commission prepared two cost/benefit analyses for the internal EDGAR system—both of which are inadequate because of incorrect assumptions.

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### The February 19, 1986, Analysis

This first analysis emanated from the two principal divisions (Corporation Finance and Investment Management) implementing EDGAR. The analysis estimated total savings of 178 staff years (53 for Corporation Finance Division and 125 for Investment Management Division) for EDGAR internal system benefits to the Commission for fiscal years 1985-90. The analysis did not attempt to convert projected staff-year savings to dollar savings and did not compare estimated internal system costs (though the second analysis included such a comparison).

The February 19 analysis included assumptions relating to the implementation and phase-in of filers, growth of filings, and EDGAR capabilities. For example, assumptions by the Corporation Finance Division included the successful development of financial-statement ratio calculations; the Investment Management Division assumed the development of a scanning routine to look for unusual words or phrases and identify for review filings that would not have otherwise been reviewed. Our review of this analysis showed that the divisions generally used a reasonable approach, estimating average time savings for portions of their review processes.

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<sup>13</sup>Guidelines for Documentation of Computer Programs and Automated Data Systems for the Initiation Phase, Federal Information Processing Standards Publication 64, National Bureau of Standards, August 1979.

However, in reviewing estimated savings for the Investment Management Division, we found very little benefit shown for its review process—total savings of only 12 staff years. Instead, the majority of this division's estimated staff-year savings (113 of 125 or 90 percent) are attributed to the use of microcomputers to automate investment company and investment adviser inspections—equipment and functions not part of EDGAR. Through discussions with division officials who prepared the analysis we determined that these savings are based on the acquisition and use of about 80 microcomputers to conduct field inspections and not directly to the use of EDGAR data. While some qualitative benefits for inspections could be realized based on EDGAR, quantitative benefits (attributable to, for example, generating computerized workpapers for transmission back to the Commission and processing data maintained on registrants' computer systems) would be attained with microcomputers regardless of EDGAR. In addition, these microcomputers will not be purchased with EDGAR funds and are not reflected in EDGAR costs used for the analysis.

In the analysis, Commission staff cautioned that implementation of EDGAR should not be justified as a cost-savings measure only to the Commission and noted other anticipated qualitative benefits. These included the ability to do new research and analysis functions, increased quality of review through rapid access to data bases, enhanced ability for comparative analysis of data between companies, and easier identification of filing precedents. Other qualitative benefits noted include improved dissemination of information, internal controls, availability of statistical information, and responses to the investment community due to one-stop filing with the Commission and the states. The study did not specifically describe how these benefits would accrue, the form they would take, or precisely who would receive them.

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The February 25, 1986,  
Analysis

Six days later, the Commission's Executive Director issued an analysis stating that, because of its substantial cost, EDGAR must demonstrate savings or sufficient improvements (such as productivity increases) equal to or greater than its total cost to justify expenditure of Commission resources. The Executive Director considered the first analysis too conservative and dramatically increased savings estimates in his analysis. He based his savings estimates on the assumption that productivity would improve more significantly than the divisions estimated, particularly through the use of artificial intelligence. The second analysis also estimated the internal system's total costs at \$40 million (based on \$35 million plus costs totaling an additional \$5 million over 7 years for other

equipment and implementation staffing). The projected staff-year savings of the analyses are summarized and compared in table 4.1.

**Table 4.1: Difference in Staff-Year Savings for Fiscal Years 1987-90**

Division	Analyses		Difference Between Analyses	
	2/19/86	2/25/86	Amount	Percentage of 2/19/86 Analysis
Corporation Finance	53	285	232	438
Investment Management	125	163	38	30
<b>Total</b>	<b>178</b>	<b>448</b>	<b>270</b>	<b>152</b>

Our review of the second analysis showed that little additional analysis had been done to estimate quantitative benefits. Several factors make the second analysis inadequate as a basis for deciding to proceed with the operational system at this time.

- There are significant technical limitations to incorporating the pilot-tested artificial intelligence system into the operational system. Since the Commission did not make such a subsystem a firm requirement in the RFP, we believe it unlikely that the productivity improvements attributed to artificial intelligence will be realized.
- The second analysis incorporates all estimated savings attributable to Investment Management Division inspections that we believe are inappropriate in justifying EDGAR.
- The second analysis expands the staff-year savings (shown in table 4.1) to the full 7 years of system life and projects total savings at \$42.3 million. Even with the dramatic increases of the second analysis, quantitative benefits exceed costs by only \$2.3 million—allowing little more than a five percent margin of error for these benefit estimates.
- Development costs for the operational system will likely exceed the \$35 million estimated, and do not include the costs of the receipt portion of EDGAR. We believe these should be included in the analysis of internal system costs.

## Internal Audit Also Questions Analyses

The Commission's Office of Internal Audit (Internal Audit) also reviewed the Commission's analyses of quantitative costs and benefits for the internal EDGAR system. The resulting May 1986 report disclosed some of the same deficiencies we noted after review of these analyses, and prompted the Commission to identify additional quantitative benefits for the internal EDGAR system. However, the benefits as adjusted by

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Internal Audit still total only \$21.4 million compared to the \$40.0 million cost estimate. These findings show that the Commission's cost/benefit analyses do not provide an adequate basis for proceeding with development of the operational EDGAR system. They also reinforce that quantitative benefits alone do not support continued system development.

Internal Audit evaluated the internal costs and benefits presented in the analyses of February 19 and 25, 1986, and estimated that approximately \$7.5 million in direct benefits can be reasonably expected from the successful implementation of EDGAR exclusive of any qualitative benefits that Internal Audit did not analyze. In responding to Internal Audit findings (that costs exceeded quantifiable benefits), the Executive Director stated that qualitative benefits were the principal justification for proceeding with EDGAR, a position not taken in his original analysis.

Specific issues raised by Internal Audit's review of costs and benefits of the internal system included those listed below.

- The extent of benefits and related costs for the Investment Management Division's inspection program were considered unclear, and Internal Audit excluded them from its projection of internal system benefits.
- Assumptions of dramatic productivity increases due to artificial intelligence were eliminated because of immature artificial intelligence technology, its absence from RFP requirements, and failure to reflect costs for its development in the analysis.
- Pilot-system hardware cannot be readily considered to offset internal system funding amounts.

The Executive Director provided formal comments on each issue. On the first, he stated that the key to inspection productivity improvements will be access to the data base and use of a microcomputer for exchange of data with the central computer. However, similar to us, Internal Audit noted that their interviews with Investment Management Division staff indicated that (1) EDGAR data were not the primary source of productivity-improvement estimates and (2) costs for achieving such benefits were not reflected in the Commission's analysis. As a result, Internal Audit excluded benefits attributable to the inspection program from its cost/benefit analysis.

On the second issue, the Executive Director stated that artificial intelligence is complicated, somewhat ill-defined, and, as an expert system like that used in the pilot, is too immature technologically to project for EDGAR. Therefore, he substituted "automated review assistance" as the

operative concept and noted productivity increases due to full text search, electronic screening, access to outside data bases, and other automated review routines. Internal Audit believes that the division's estimates in the first cost/benefit analysis included the aspects of automated review assistance to which he refers and, therefore, used the divisions' estimates for its analysis, not those in the second cost/benefit analysis.

Regarding the last issue, the Executive Director felt that the pilot-system hardware (IBM mainframe, storage devices, printers, disk and tape drives, terminals, and operating software) can and will be used in the operational system and should be treated as an offset to the \$35 million in funding. Internal Audit's position is that in its 1987 budget submission, the Commission noted funding needs of \$5.192 million per year for EDGAR and did not subtract the costs of the pilot hardware. Thus, Internal Audit believes that proper and consistent treatment would include the pilot equipment as an addition to the \$35 million rather than as an offset. We agree. Our review showed that, according to the RFP, use of the pilot system equipment is to be negotiated and there is no specific reference to considering such use as an offset to funding amounts.

Internal Audit considered comments from Commission staff on these issues, but its final report changed little with regard to quantitative internal benefits. On July 10, 1986, Internal Audit issued an addendum to its report in response to reevaluated estimates from the Commission staff. In this addendum, Internal Audit added about \$13.9 million to benefits shown in the original report to arrive at adjusted quantitative internal benefits totaling \$21.4 million, or about 53 percent of the Commission's estimated total cost of \$40 million. Additional benefits included were

- approximately \$2 million as a result of including overhead in the original staff-year savings estimates;
- almost \$7 million for equipment and staff savings resulting from transferring functions currently performed by the Commission's existing WORKLOAD system, which no longer will be needed since EDGAR could provide the same statistical information;
- savings of \$3.8 million for the Corporation Finance Division attributed to other activities in its review of filings as well as benefits in the rulemaking, monitoring, and legal interpretation functions; and

- 
- about \$1.1 million in other benefits for the Directorate of Economic and Policy Analysis, the Investment Management Division, and the Office of Consumer Affairs and Information Services.

# Conclusions, Recommendations, and Agency Comments and Our Evaluation

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## Conclusions

We commend the Commission for seeking to take advantage of current information processing and communications technology to benefit the public, filers, and its internal operations. However, because the operational EDGAR system will significantly change the receipt, review, and disclosure of financial investment data, the Commission and the Congress need to be sure that their multi-million dollar investment is sound and properly justified. We believe that the Commission is proceeding without having resolved certain important policy and cost issues that may affect both EDGAR's achieving the full benefits envisioned by the Commission and the ultimate cost of the system to the government.

Since the Commission only recently began to formally and comprehensively obtain filer comment on proposed changes to filing requirements, it does not know the extent to which filer exemptions or opposition to these requirements will limit their implementation. As a result, the Commission cannot be sure that it will achieve projected EDGAR benefits because they are based on most filers adhering to proposed electronic filing requirements including electronic submission of exhibits, material incorporated by reference, and financial data in a Commission-specified format. In addition, the Commission does not know whether this limited implementation will result in an incomplete, perhaps less marketable, data base and limit the contractor's ability to recover costs. We believe that, prior to proceeding with operational system development, the Commission should resolve these filing issues to assess their impact on system requirements and to incorporate any changes to these requirements in the RFP for offerors' consideration in preparing their proposals.

According to existing law and OMB policy, the amount that may be charged for furnishing information cannot exceed the cost of providing that information. In the case of a contractor, this includes a reasonable profit, but not costs for internal processing (creation, collection, processing, and transmission of information). We believe the receipt system is a logical part of the Commission's internal processing mission requirements, and thus prevents the Commission's recovering the costs of developing and operating this system through contractor charges to public users. Furthermore, we believe the Commission's financing approach for the receipt system and its fixed-price funding for the internal system bypasses the congressional authorization and appropriation process to some degree, limiting the oversight and control of EDGAR development and operation the Congress intended.

Finally, the Commission has not adequately analyzed the costs and benefits of the EDGAR project and, therefore, we believe its decision to proceed with the operational system is premature. Without the benefit of better estimates of costs and quantitative benefits and an adequate description of qualitative benefits, the Commission and the Congress cannot ensure that they are making an informed decision on development and funding of EDGAR.

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### Recommendations to the Commission Chairman

We recommend that the Chairman of the Securities and Exchange Commission not award a contract for the operational EDGAR system until

- the impact of potential filer exemptions from and opposition to proposed electronic filing requirements has been fully assessed and considered in defining the system;
- the financing approach for the operational system has been resolved with the Congress to provide appropriate funding for the Commission's internal processing requirements; and
- a comprehensive cost/benefit analysis that better estimates the total costs of the internal system and its quantitative benefits and adequately describes the qualitative benefits of EDGAR has been completed.

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### Recommendation to the Congress

We recommend that the Congress satisfy itself that the Commission has adequately responded to the issues raised in this report before providing funding for the operational EDGAR system.

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### Agency Comments and Our Evaluation

We provided a draft copy of this report to the Commission, which responded with the executive summary included at the end of this report (see appendix II and our evaluation of Commission comments). The Commission disagrees with our findings on obtaining filer comments and the legality of their funding approach, and our conclusions and recommendations. However, after assessing the Commission's comments, we still believe that before awarding a contract for the operational EDGAR system, the Commission needs to (1) determine the extent that filer exemptions will impact EDGAR requirements, (2) develop an appropriate funding approach for the internal system to include the receipt portion, and (3) prepare a comprehensive cost/benefit analysis. The Commission's primary concerns and our responses are presented below. Based on the Commission's executive summary and additional detailed comments (not included here), we have also made technical corrections to the report where appropriate.

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## Filer Comments

The Commission believes that during the past 3 years, it has solicited and obtained extensive comments and suggestions on EDGAR from a wide range of sources (the Commission listed 51 such conferences and solicitations in its response to this report). The Commission contends that it is coordinating the promulgation of rules for mandated electronic filings with the issuance of the RFP so that it can carefully consider comments and suggestions from all parties, particularly the contractor.

We reviewed the Commission's list of commenters and found that many of those listed either did not involve filers or apparently did not provide filer comments. For example, 11 on the list concerned comments from potential vendors for the pilot and operational systems. Further, seven open Commission meetings (also included on the list) show that EDGAR was an agenda item, but comments from filers were not indicated. We agree that other meetings, conferences, and solicitations the Commission lists could provide some filer comment, particularly those with pilot participants (as noted in our report) and financial printers (who prepare filings for some filers). However, our review showed and Commission officials agreed that no comprehensive, formal request for filer comments on proposed filing requirements for the operational system was initiated prior to the advance notice of proposed rulemaking begun in June 1986—over one month after the RFP was issued. In addition, while comments from potential contractors can be useful, we believe final electronic filing requirements are more dependent on filer capabilities than on contractor preferences. Contractors should know what the actual requirements will be when preparing their proposals.

Regarding the rulemaking process, the Commission has begun to receive filer comments that illustrate the information we believe the Commission should have used to determine electronic filing requirements. We reviewed 88 of these comments, which came from pilot participants, associations representing thousands of filers, corporations, and interested parties such as attorneys and accountants who represent filers. Our review showed mixed reactions to the Commission's proposed filing requirements. The Commission believes that it has designed the system to accommodate virtually all filers, and therefore, exemptions will be limited and will not materially impact the benefits of EDGAR. While most comments we reviewed support the electronic filing concept, they also express concern about the costs and burden associated with the Commission's proposed electronic filing requirements. Comments

show that smaller companies may require exemptions and that companies, regardless of size, might need a temporary exemption due to technical difficulties. Both situations would result in continued submission of paper filings.

The Commission also believes that electronically filing exhibits and other previously filed paper documents now referenced in electronic filings will also be accepted because filers will be phased in. The comments we reviewed, however, indicate that filers may not readily accept this provision. Many filers are concerned about the time and expense involved in electronically filing exhibits that are often quite lengthy. For similar reasons, they also strongly reject the Commission's proposal to require electronic resubmission of previously filed paper documents that are referenced in electronic filings.

As for the Commission-specified format to identify financial data for calculating financial ratios, the Commission states that pilot participant responses have been positive and that the schedule is easy to prepare. Comments we reviewed indicate that filers agree it is relatively easy to prepare the schedule; however, they are concerned that this approach (1) may establish the form of financial statements, (2) does not provide for filers' individual interpretations of rules, and (3) does not consider that additional data may be available in footnotes. Commenters also express concern that this schedule may be a first step in requiring additional formatted financial data that may place an undue burden on filers.

To the extent that these comments and others indicate a need to grant exemptions to electronic filing and/or limit the implementation of other proposed requirements, the Commission may have to revise system requirements and amend the RFP. Further, the Commission may also have to retain portions of the current manual paper process or devise an input scheme to handle filings that continue to be submitted in paper form. This could result in either a reduction of EDGAR benefits and marketability of EDGAR information, or increased costs for receiving filings. Such changes would also need to be reflected in a revised cost/benefit analysis.

Because of the nature of the comments we reviewed, we have clarified our recommendation concerning filer comments to fully recognize the impact they may have on the operational EDGAR system requirements.

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Funding the Receipt Systems

The Commission disagrees that its financing approach is contrary to existing law. It states that its General Counsel has determined that a no-cost or shared-cost approach is legally sound. The Commission states that by providing the public free access to filing information through EDGAR terminals and paper copies of filings at a charge no greater than the cost of document search and duplication plus regulated contractor profit (in its public reference rooms) it meets the requirements of both FOIA and the User Charge Law.

We agree that the public reference rooms satisfy FOIA requirements. However, at issue is what costs should be included in the cost base for setting user fees to be charged to subscribers wishing a copy of the entire or a portion of the data base. The difference in our position and that of the Commission centers on the funding of the receipt system.

The Commission contends that it does not bear the costs of delivery under the present manual receipt system because filers pay to deliver their filings to the Commission. Further, it believes that receiving and disseminating filings are interrelated and dependent functions, and should be operated as a single system funded by the contractor. However, we note that filers will continue to bear the costs of delivery for EDGAR—postage or delivery fees for tapes and diskettes and telephone charges for direct transmission. Also, users of filing information, not filers, will pay for the receipt system under the Commission's proposed funding approach through fees charged by the contractor. Further, the receipt system itself is necessary for the Commission to initially receive a filing and perform acceptance processing. A filing must be formally accepted by the Commission before it can be made available for dissemination. In addition, once received in electronic format, the Commission intends to use automated techniques to aid in its review processes. Given these factors, we do not agree with the Commission's argument that receipt and dissemination are interrelated and should be funded by the contractor. Moreover, combining the receipt and dissemination functions into a single system does not preclude segregating their cost.

Our position, first voiced in our March 14, 1985, testimony on the initial no-cost funding proposal, has been that if the Commission is providing to the public any legally required information services or voluntarily provides information dissemination services, it may not recover fees that exceed the limitations on assessing and recovering fees under the provisions in the FOIA and the User Charge Law. We oppose including costs related to supporting the Commission's own processing needs, such as the receipt system, in the cost base used to assess fees charged

requestors of information. This is because the former are unrelated to search and duplication (authorized for recovery under FOIA) or because they are incurred to serve an independent public interest (excluded under the User Charge Law). To include costs related to internal processing would permit the Commission to recover costs unrelated to search and duplication from the public by interjecting a no-cost contractor between itself and the public; it would also allow the Commission to recover costs that could not be recovered were it developing the system using its own resources.

We therefore stand by our position that (1) funding the receipt system through dissemination charges is contrary to existing law and (2) the Commission should include these costs in its appropriation requests for the EDGAR system.

The Commission disagrees that its proposed funding approach will limit congressional oversight. The Commission provided a list of 36 congressional meetings, testimony, reports, and other communications that it believes demonstrate that EDGAR has received oversight. We are aware of many of these meetings because of our initial review of the EDGAR project in March 1985, and agree that the Commission included the EDGAR program in its budget requests and consulted with and provided requested information to the Congress. However, we still believe that recovering the receipt system's cost through user charges and using fixed-price funding for the internal system each mask the true cost of providing EDGAR processing capabilities to the Commission. Annual funding amounts requested by the Commission bear little relationship to the actual costs incurred by the contractor. As a result, the Congress would not be routinely aware of situations that could affect either completion of the EDGAR project or its potential cost to the government. For example, inability of the contractor to recover internal system costs exceeding the Commission's \$5-million annual contribution could jeopardize contract performance. Also, the approval of fixed funding amounts annually does not indicate the potential government liability from other contractor costs if the contract is terminated for the convenience of the government.

#### Cost/Benefit Analysis

The Commission now states that the cost/benefit analyses it performed to justify EDGAR were preliminary despite their use as a basis for proceeding with operational system development. It also states that it used the wrong hardware configuration in estimating the cost of the internal system, and that the \$21.4 million identified as quantifiable benefits

cover only half of the system's estimated \$40-million cost. Nevertheless, the Commission believes that it should proceed with EDGAR because "...it will increase the efficiency and fairness of the securities markets for the benefit of investors, corporations, and the economy...." In its detailed comments, the Commission also expands on other potential quantitative and qualitative benefits to itself and the potential qualitative or "external" benefits to users, corporate filers, and regulators. With this recognition that costs far outweigh quantifiable internal benefits, the Commission's decision to proceed with EDGAR, therefore, rests solely upon its belief that sufficient external benefits will accrue to filers, regulators, investors, and the general public. Because these benefits are essential to the Commission's justification to proceed with EDGAR, it must prepare a comprehensive cost/benefit analysis that includes a clear and objective description of how these benefits will accrue, what form they will take, and precisely who will receive them. Only after such an analysis is prepared will the Commission and the Congress have adequate information to decide whether to proceed with EDGAR development.

The Commission further states that the tangible evidence that the benefits of EDGAR outweigh its costs will be the formal bids by contractors because they will be unwilling to invest much of their capital unless they believe the benefits significantly outweigh the costs. We requested and received from the Commission copies of letters (sent by potential vendors) that prompted the Commission to defer the due date for proposals from September 10, 1986 to December 31, 1986. These letters, from well-established vendors, inform the Commission that each had decided not to bid on the operational EDGAR system as defined in the original RFP. The vendors generally believe the Commission's estimates of system costs are understated, and the benefits to be realized are questionable because the market for EDGAR information is unproven. Therefore, they concluded that the Commission was asking them to take an inordinate business risk, and they offered numerous suggestions to the Commission to help reduce vendor costs and improve their market share. The Commission has acknowledged these suggestions and is considering changes to the RFP to address the vendors' concerns. Such changes could have a significant impact on EDGAR costs.

We believe that neither detailing qualitative benefits to us nor negotiating requirements with potential vendors relieves the Commission of its responsibility to prepare a comprehensive cost/benefit analysis for the

internal system. The analysis should include accurate costs for hardware and software and the receipt portion of the system, and all pertinent quantitative and qualitative benefits. The Commission and the Congress need this information because of the large expenditures to be incurred over several years, the complexity of the system being developed, and the significant impact that electronic filing will have on the gathering and disclosure of the nation's financial investment information. Until this analysis is performed and the other issues we raised in our report are adequately responded to, we do not believe the Commission should award a contract for EDGAR development. Nor should the Congress provide funding for the operational system.

# Request Letter

NINETY-NINTH CONGRESS

ROOM 2223  
RAYBURN HOUSE OFFICE BUILDING  
PHONE (202) 225-4441

JOHN D. DINGELL, MICHIGAN, CHAIRMAN

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MICHAEL F. BARRETT, JR.  
CHIEF COUNSEL/STAFF DIRECTOR

**U.S. House of Representatives**  
**Subcommittee on Oversight and Investigations**  
**of the**  
**Committee on Energy and Commerce**  
**Washington, DC 20515**

October 1, 1985

The Honorable Charles A. Bowsher  
Comptroller General  
General Accounting Office  
441 G Street, N.W.  
Washington, D.C. 20548

Dear Mr. Bowsher:

In February 1985, the Subcommittee on Oversight and Investigations requested that the General Accounting Office review the Securities and Exchange Commission's (SEC) development, procurement and implementation of the Electronic Data Gathering, Analysis and Retrieval system (EDGAR). The GAO's review of the EDGAR system revealed serious deficiencies. Messrs. James Watts, Melroy Quasney and Anthony Cicco of the Information Management and Technology Division testified about these problems at the Subcommittee's March 14, 1985 hearing regarding the EDGAR system. This GAO testimony was invaluable in assisting the Subcommittee in identifying problem areas and preparing an authorization report concerning the EDGAR system.

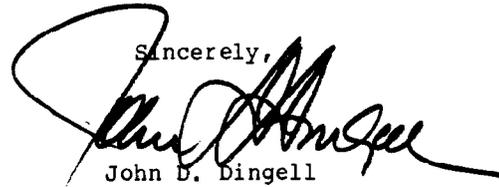
The Subcommittee remains concerned that the EDGAR system will not meet its original program goals within the time and budget limits proposed by the SEC. Because of its concern that the EDGAR project be handled in the appropriate manner, the Subcommittee requests that the GAO evaluate, monitor and conduct a complete audit of the EDGAR system, as well as its procurement and implementation, at the conclusion of the pilot program and report its findings to the Subcommittee.

Should you have any questions regarding this request, please contact R.C. Norwood or John Chesson of the Subcommittee staff at 225-5365.

The Honorable Charles A. Bowsher  
October 1, 1985  
Page 2

Thank you for your assistance with the work of the  
Subcommittee.

Sincerely,

A handwritten signature in black ink, appearing to read "John D. Dingell". The signature is fluid and cursive, with a large initial "J" and "D".

John D. Dingell  
Chairman  
Subcommittee on  
Oversight and Investigations

JDD:RCN/sf

# Comments From the Securities and Exchange Commission

Note: GAO comments supplementing those in the report text appear at the end of this appendix.



EXECUTIVE DIRECTOR

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

September 15, 1986

Mr. William J. Anderson  
Assistant Comptroller General  
U.S. General Accounting Office  
Washington, D.C. 20548

Dear Mr. Anderson:

The Securities and Exchange Commission appreciates this opportunity to comment on the General Accounting Office's August 15, 1986 draft report on Edgar. It is respectfully requested that the nine-page Executive Summary of the Commission's comments be included in the final GAO report.

If in consideration of the Commission's comments, one or more of the recommendations in the August 15th draft GAO report are modified, the Commission would be pleased to delete or modify its comments accordingly.

With the benefit and timely receipt of the final GAO report, the Commission will give further serious consideration to GAO's recommendations, prior to awarding the operational contract next spring.

The Commission appreciates the advice and counsel of the General Accounting Office in effecting this important conversion from a manual paper to an electronic disclosure system.

If you have any questions concerning the response, please contact me at 272-2700.

Sincerely,

  
George G. Kundahl  
Executive Director

I. Executive Summary

The GAO draft report focuses among other things, on the internal benefits of the Edgar system to the SEC. While significant, they are a tiny fraction of the benefits to investors, corporations and the economy.

The primary purpose of Edgar is to increase the efficiency and fairness of the securities markets for the benefit of investors, corporations and the economy, by accelerating dramatically the filing, processing, dissemination and analysis of time-sensitive corporate information.

Under Edgar, as such information is electronically filed with the Commission, it will be accessible to investors, the media and others on personal and business computer screens in minutes, instead of days and weeks. This is but one of the major benefits cited herein.

The 735 Edgar pilot participants <sup>1/</sup> have filed over 8,100 documents. The participants include a wide variety of large and small corporations, investment companies, limited partnerships and others. Many simply type their filings on microcomputers (which retail for less than \$2,000) and transmit them to the Commission over telephone lines or on magnetic tapes or diskettes, instead of having them printed on paper and manually delivered and processed by the Commission. Staff comments are provided Edgar filers by electronic mail. Investors and others will be able instantly to access electronically such information with equipment that retails for less than \$1,000, such as a personal computer and modem (a telephone connection device).

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<sup>1/</sup> This includes 397 participants in the Corporation Finance and Investment Management pilots; 15 public utility holding companies; and, 323 companies filing only the investment company semi-annual report.

See comment 1

See comment 2

The Institutional Investor has indicated that Edgar could revolutionize the manner in which investment decisions are made and executed. <sup>2/</sup> Based upon surveys, Mathematica Policy Research, Inc., has approximated the market for electronic filings at up to \$2.2 billion per annum. <sup>3/</sup>

Tangible evidence of the benefits of the Edgar system will be the formal bids of contractors this December. Bidders will not be willing to invest large amounts of their own capital in Edgar, unless they have satisfied themselves that the benefits significantly outweigh the costs.

The GAO draft report commends the Commission "for seeking to take advantage of current information processing and communication technology for the benefit of the public, the filers and the Commission's internal operations," and states that "the pilot project [has] demonstrated that the Commission could receive, analyze and disseminate filings electronically."

Edgar is also responsive to the Federal initiative to reduce the paperwork burden through automation technology. As the GAO has stated:

"One of the purposes of the Paperwork Reduction Act was to ensure that automatic data processing and telecommunications were used by Federal managers to reduce the paperwork burden on both the public and the Government." <sup>4/</sup>

The GAO draft report recommends that before awarding the operational contract the SEC should:

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<sup>2/</sup> "The Edgar Revolution"; Institutional Investor, September, 1984.

<sup>3/</sup> Potential Impact of the Edgar System on the Market for Securities Information, June, 1984.

<sup>4/</sup> U.S. General Accounting Office Study, Better Use of Information Technology Can Reduce the Burden of Federal Paperwork, April 11, 1983, GAO/GGD-83-39. at 1.

Appendix II  
Comments From the Securities and  
Exchange Commission

- Better identify the extent of filer opposition to, and exemption from, electronic filing procedures and formats;
- Resolve the issue of whether financing the receipt system through user fees, rather than appropriated funds, is contrary to existing law and public policy; and
- More accurately determine the total costs and quantitative benefits, and more adequately describe the qualitative benefits associated with Edgar.

The Commission considered these issues well before issuing the Request for Proposals on May 7, 1986. At a meeting of the full Commission on September 2, 1986, the Commission unanimously reaffirmed that:

- Based on three years of Pilot development and operations, and extensive comments from filers and others, the operational Edgar system is responsive to the needs and interests of filers, investors and others;
- The Edgar funding approach fully complies with the law; and
- The benefits of Edgar far outweigh the costs.

However, with the benefit and timely receipt of the final GAO report, the Commission will give further serious consideration to GAO's recommendations prior to awarding the operational contract next spring. The Commission appreciates the advice and counsel of the General Accounting Office in effecting this important conversion from a paper to an electronic disclosure system.

On September 3, 1986, the Commission announced extension of the date for the submission of bids on the Edgar electronic disclosure system from September 10th to December 31st in order to consider comments received from potential bidders and others. <sup>5/</sup>

Electronic Filing Procedures and Formats

During the past three years, the Commission has solicited and obtained extensive comments and suggestions on Edgar from members of Congress and their

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<sup>5/</sup> This announcement is set forth in Appendix 1.

Appendix II  
Comments From the Securities and  
Exchange Commission

See comment 3

See comment 4

staffs, the General Accounting Office, the business and financial community, institutional and individual investors, corporations, Edgar pilot participants, potential bidders, the securities exchanges, the National Association of Securities Dealers, the state securities commissions, attorneys, accountants, economists and experts from within and outside of government. <sup>6/</sup> The comments and suggestions have been very helpful and constructive. Over a hundred have been incorporated in the Edgar system.

The Commission is coordinating the promulgation of Edgar rules <sup>7/</sup> with the issuance of the Request for Proposals in order to carefully consider comments and suggestions of all interested parties, including the contractor. The contractor's views on phasing-in filers, the format of filings and related rules are important considerations in the implementation of a sound operational system.

With respect to hardship exemptions from Edgar filing, the Commission has designed Edgar to accommodate virtually all filers. In addition to the speed and simplicity of filing reports electronically, Edgar will receive transmissions from virtually all publicly available microcomputers and word processors. The Edgar pilot already accepts filings from more than 85 different systems. Comments of pilot program participants underscore the low cost and ease of use of the Edgar system. Because of the ease of electronic filing, the Commission expects that requests for exemptions will be limited and will not materially impact the benefits of Edgar to the investing public, issuers, the Commission or the contractor.

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<sup>6/</sup> A list of over 40 such conferences and solicitations of comments is set forth in Appendix 2.

<sup>7/</sup> See Advance Notice of Proposed Rulemaking; Release No. 33-6651, 51 FR 24155 (July 2, 1986).

Appendix II  
Comments From the Securities and  
Exchange Commission

As for formatting, pilot participants have been requested to include with certain filings a one-page schedule of up to 38 key financial items with their filings. These items are already included in their financial statements and more than 100 such schedules have been voluntarily submitted. Filers report that it takes less than an hour to prepare such schedules, which permit Edgar instantly to compute key financial ratios for staff analysis.

Edgar Funding

GAO's questions concerning the legality of the proposed funding of Edgar may reflect a misunderstanding of the public's ability to obtain copies of filings under Edgar. The public will have greater and faster access to filings than at present. They will have free on-line access to the Edgar database in fourteen of the Commission's offices, as compared to access to microfiche copies at three locations under the present system. In addition, the public will continue to be able to obtain paper and microfiche copies of all Edgar filings at duplication cost plus a regulated profit to the dissemination contractor as at present. Thus, members of the public requesting copies of filings through the Commission's public reference facilities will not bear any Edgar costs. This satisfies the requirements of both the Freedom of Information Act and the Independent Offices Appropriations Act.

The GAO draft report statement that the proposed funding approach is contrary to existing law is incorrect. Indeed, senior GAO officials have previously agreed that the proposed funding is lawful. On April 29 and June 12, 1986, respectively, a representative of the GAO's General Counsel and a senior official of GAO informed the Commission's staff that GAO was not challenging the Commission's legal interpretation.

See comment 5

See comment 6

See comment 7

To the extent that legal questions raised in the draft report rest on the proposition that government functions must be fully financed by appropriated funds, the Commission is aware of no such requirement and GAO has cited none. To the contrary, the Commission's General Counsel has provided GAO a legal memorandum on the precedent and propriety of the proposed funding. 8/

See comment 8

Also, the proposed funding does not limit Congressional oversight of Edgar. Such oversight will continue as at present through authorization, appropriations and other processes. Funding of the operational contract is subject to annual appropriations by Congress. The Commission has kept its oversight and other Congressional committees informed of the progress on Edgar, and will continue to do so. 9/

Cost/Benefit Analysis

See comment 9

Investors, issuers and the economy will be the principal beneficiaries of Edgar. Their benefits include:

- ° Access by investors, the media and the public to time-sensitive corporate information in minutes instead of days and weeks;
- ° Greater equality of access to such information, which will promote fairness in the securities markets;
- ° Greater utility of such information, due to the ease and speed of electronic retrieval and analysis;
- ° Improved access to information on publicly-traded companies, including smaller companies; and
- ° Faster access to the market by corporate issuers and greater flexibility in adapting corporate financings to changing market conditions.

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8/ SEC General Counsel memorandum of March 12, 1985.

9/ A list of 36 such Congressional meetings, testimony, reports and other communications is attached as Appendix 3.

Appendix II  
Comments From the Securities and  
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General Motors Acceptance Corporation ("GMAC"), a frequent Edgar filer, has stated that Edgar has permitted them to take advantage of "market windows" at substantial savings. Other pilot participants have also indicated that Edgar permits them to make changes up until the instant of filing; reduce printing and delivery costs; receive and respond faster to staff comments; file on a same day basis from the West Coast; and improve their internal operations. <sup>10/</sup>

Edgar will also significantly improve the Commission's internal operations. The SEC staff cost/benefit analysis provided to GAO includes substantially all Edgar-related costs to the SEC, but not all the benefits. The \$40 million estimated costs over the seven-year operational contract include non-recurring development and transition costs, as well as a \$3.2 million contingency reserve (not cited in the GAO draft report). <sup>11/</sup> The staff analysis also identifies internal benefits and quantifiable productivity improvements primarily in the Corporation Finance and Investment Management Divisions and the Office of Information Systems Management. Such quantifiable benefits amount to \$21.4 million (i.e., over 50% of the \$40 million total estimated cost to the SEC).

It was not considered cost-effective to attempt to quantify the benefits of future system enhancements, qualitative improvements in the Commission's review process, or the benefits to the Enforcement and Market Regulation Divisions, the regional offices and the Offices of the General Counsel, Chief Accountant and Chief Economist, all of which will have Edgar terminals and are expected to

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<sup>10/</sup> See Berney, "Let Edgar Do It," Nation's Business, December 1985, at 85; Jayson, "Filing into the Future with Edgar," Management Accounting, June 1985, at 21, and Robertshaw, "Edgar is taking a bite out of all that SEC Paperwork," Women's Wear Daily, July 17, 1985.

<sup>11/</sup> The \$40 million consists of the \$35 million fixed price contract, plus \$5 million in personnel costs.

See comment 10

make increasing use of Edgar's high-speed retrieval, word search, comparative tabulation and other capabilities.

See comment 11

Also, a computer model discussed in the staff analysis (but not included in the estimated dollar benefits) projects a \$4.9 million increase in benefits for each additional 10% increase in filings processed per staff year.

See comment 12

The GAO draft report is correct that an IBM simulation model 12/ indicated that the internal processing system will need the equivalent of an IBM 3090-200, instead of an IBM 3081. The \$1.1 million additional cost of an IBM 3090-200 is well within the \$35 million fixed cost contract. The IBM model also indicated the possible need to upgrade to an IBM 3090-400 in 1992. However, such an upgrade is not expected to be necessary because of ongoing hard and software enhancements by IBM and others. In any event, there has been a long term trend of declining mainframe costs as a result of increasing competition and ongoing technological improvements. 13/ The GAO also noted this trend in a report on the securities industry 14/.

See comment 13

The GAO draft report notes that development costs are difficult to estimate, but does not take into account the fact that the internal cost estimates include, and the RFP requires, the contractor to provide ten staff persons each year for continuing improvements in the internal system.

#### Conclusion

In the 50 years since the enactment of the federal securities laws, the manner of filing documents with the Commission has remained unchanged --

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12/ The IBM Systems Network Analysis Program/Simulated Host Overview Technique.

13/ Gartner Group, Inc., Information Week, August 11, 1986, at 9.

14/ U.S. General Accounting Office Staff Study, Securities and Futures, GAO/GGD-86-26 at 16.

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physical delivery of multiple copies of paper documents. Through the years, the number of filed documents has multiplied to seven million pages per annum, plus multiple copies. The volume continues to grow at over 700,000 pages a year. Similarly, the dissemination of filed documents, while taking advantage of developments in copier and microfiche technology, also remains firmly rooted in paper - based technology.

The securities industry and markets would not be able to handle the present volume of trading and financings if they had not converted from manual to electronic data processing and telecommunication systems over a decade ago. As the GAO noted in a recent study, "advances in computer and telecommunications technology have facilitated the geographical dispersion of services, helped improve market operations, and given customers new ways to use the markets." <sup>15/</sup> Edgar is a quantum leap forward in the application of state-of-the-art telecommunication technology to the Commission's full disclosure mission. It will increase the efficiency and fairness of the securities markets for the benefit of investors, corporations and the economy. Edgar will achieve this goal by accelerating and improving dramatically the filing, processing, dissemination and analysis of time-sensitive corporate information.

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<sup>15/</sup> GAO/GGD-86-26 at 15.

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Comments From the Securities and  
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OFFICE OF  
ADMINISTRATIVE  
SERVICES

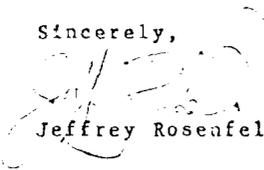
UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

September 4, 1986

**ALL PROSPECTIVE OFFERORS:**

Attached for your information is a press release and amendment to the solicitation concerning an extension of the date for submission of proposals on the Operational Edgar Electronic Disclosure System, RFP SECHQ1-86-R-0637. If there are any questions about these matters contact Jeffrey Rosenfeld, Chief, Procurement and Contracts Branch at (202) 272-7010

Sincerely,

  
Jeffrey Rosenfeld

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<b>AMENDMENT OF SOLICITATION/MODIFICATION OF CONTRACT</b>				1. CONTRACT ID CODE	PAGE OF PAGES
					1   1
2. AMENDMENT, ORDER OR CONTRACT NO.	3. EFFECTIVE DATE	4. REQUISITION/PURCHASE REQ. NO.	5. PROJECT NO. (If applicable)		
0004	4 Sep 1986	N/A			
6. ISSUED BY		7. ADMINISTERED BY (If other than Item 6)			
CODE		CODE			
Securities and Exchange Commission Procurement and Contracts Branch 450 5th Street, NW; Room 2015/2-1A Washington, D.C. 20549					
8. NAME AND ADDRESS OF CONTRACTOR (No., street, county, State and ZIP Code)				9A. AMENDMENT OF SOLICITATION NO.	
ALL PROSPECTIVE OFFERORS				SECHQ1-86-R-0637	
				9B. DATED (SEE ITEM 11) May 7, 1986	
				10A. MODIFICATION OF CONTRACT/ORDER NO.	
				10B. DATED (SEE ITEM 13)	
CODE	FACILITY CODE				
11. THIS ITEM ONLY APPLIES TO AMENDMENTS OF SOLICITATIONS					
<input checked="" type="checkbox"/> The above numbered solicitation is amended as set forth in Item 14. The hour and date specified for receipt of Offers <input checked="" type="checkbox"/> is extended, <input type="checkbox"/> is not extended.					
Offers must acknowledge receipt of this amendment prior to the hour and date specified in the solicitation or as amended, by one of the following methods: (a) By completing Items 8 and 15, and returning _____ copies of the amendment; (b) By acknowledging receipt of this amendment on each copy of the offer submitted; or (c) By separate letter or telegram which includes a reference to the solicitation and amendment numbers. FAILURE OF YOUR ACKNOWLEDGMENT TO BE RECEIVED AT THE PLACE DESIGNATED FOR THE RECEIPT OF OFFERS PRIOR TO THE HOUR AND DATE SPECIFIED MAY RESULT IN REJECTION OF YOUR OFFER. If by virtue of this amendment you desire to change an offer already submitted, such change may be made by telegram or letter, provided each telegram or letter makes reference to the solicitation and this amendment, and is received prior to the opening hour and date specified.					
12. ACCOUNTING AND APPROPRIATION DATA (If required)					
N/A					
13. THIS ITEM APPLIES ONLY TO MODIFICATIONS OF CONTRACTS/ORDERS, IT MODIFIES THE CONTRACT/ORDER NO. AS DESCRIBED IN ITEM 14.					
<input checked="" type="checkbox"/> A. THIS CHANGE ORDER IS ISSUED PURSUANT TO: (Specify authority) THE CHANGES SET FORTH IN ITEM 14 ARE MADE IN THE CONTRACT ORDER NO. IN ITEM 10A.					
<input type="checkbox"/> B. THE ABOVE NUMBERED CONTRACT/ORDER IS MODIFIED TO REFLECT THE ADMINISTRATIVE CHANGES (such as changes in paying office, appropriation date, etc.) SET FORTH IN ITEM 14, PURSUANT TO THE AUTHORITY OF FAR 43.103(b).					
<input type="checkbox"/> C. THIS SUPPLEMENTAL AGREEMENT IS ENTERED INTO PURSUANT TO AUTHORITY OF:					
<input type="checkbox"/> D. OTHER (Specify type of modification and authority)					
E. IMPORTANT: Contractor <input type="checkbox"/> is not, <input type="checkbox"/> is required to sign this document and return _____ copies to the issuing office.					
14. DESCRIPTION OF AMENDMENT/MODIFICATION (Organized by UCP section headings, including solicitation/contract subject matter where feasible.)					
The above-referenced solicitation document for an Operational EDGAR System is hereby amended as follows:					
1. The deadline/closing date for receipt of offers, as stated in Block 9 on Page A-1 of the RFP (SF-33), is changed from <u>2:00 p.m. on September 10, 1986</u> to <u>2:00 p.m. on December 31, 1986</u> .					
Except as provided herein, all terms and conditions of the document referenced in Item 9A or 10A, as heretofore changed, remains unchanged and in full force and effect.					
15A. NAME AND TITLE OF SIGNER (Type or print)			16A. NAME AND TITLE OF CONTRACTING OFFICER (Type or print)		
15B. CONTRACTOR/OFFEROR			16B. UNITED STATES OF AMERICA		
15C. DATE SIGNED			16C. DATE SIGNED		
_____ (Signature of person authorized to sign)			BY _____ (Signature of Contracting Officer)		
NSN 7540-01-152-8070 PREVIOUS EDITION UNUSABLE		30-105-01		STANDARD FORM 30 (REV. 10-83) Prescribed by GSA FAR (48 CFR) 53.243	



U. S. Securities and Exchange Commission  
Washington, D. C. 20549 (202) 272-2650

News  
Release

FOR IMMEDIATE RELEASE

86-54

SEC EXTENDS EDGAR CONTRACT BIDS

Washington, September 3, 1986 - The Securities and Exchange Commission announced today extension of the date for the submission of bids on the operational Edgar electronic disclosure system from September 10th to December 31st.

The extension is to consider comments received from potential bidders and others. The comments include the possibility of scheduling payments to coincide more closely with the contractor's expenditures, permitting shared or dedicated off-site facilities and extending the seven year term of the contract. Any changes in the Request for Proposals will be published by October 31st in order to permit potential contractors to consider the impact on their bids. The pilot program will continue until the operational system begins.

The purpose of Edgar is to increase the efficiency and fairness of the securities markets by accelerating dramatically the filing, processing, dissemination and analysis of time-sensitive corporate information. Such information will be instantly accessible to investors, the media, and others on personal and business computer screens. The benefits to investors, corporations, the Commission and the economy include:

- access by investors, the media and the public to time-sensitive corporate information in minutes instead of days and weeks;
- greater equality of access to such information, which will promote fairness in the securities markets;

- more -

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- greater utility of such information, due to the ease and speed of electronic retrieval and analysis;
- improved access to information on publicly-traded companies, including smaller companies;
- faster access to the market by corporate issuers and greater flexibility in adapting corporate financings to changing market conditions; and
- significant productivity and other quantitative and qualitative improvements to the Commission in processing filings.

The contact person concerning Edgar is Amy Goodman,  
Associate Director (Edgar), (202) 272-7054.

Conferences and Solicitations of Comments on Edgar

Release-Commerce Business Daily-Sources Sought for Experimental "Paperless" Filing System	April 7, 1983
Pre-Solicitation Conference on Dissemination	May 18, 1983
Pilot Bidders Conference	January 27, 1984
Release Requesting Edgar Volunteers and Soliciting Comment - Questionnaire Regarding Equipment Compatibility	March 30, 1984
Conference with Financial Printers	May 7, 1984
Conference with Financial Printers	June 7, 1984
<u>Mathematica Study - Potential Impact of the Edgar System in the Market for Securities Information</u>	June 12, 1984
Resolution by North American Securities Administrators Association ("NASAA") Board in Support of Edgar	June 15, 1984
Release Requesting Public Comment on Edgar Temporary Rules for Division of Corporation Finance	June 27, 1984
FBI Provides Edgar Security Analysis	July 2, 1984
Conference with Financial Printers	July 27, 1984
Conference with Financial Printers	August 8, 1984
Release requesting Public Comments on Edgar Financing	August 15, 1984
Conference with Edgar Volunteer Participants	August 28, 1984
Conference at which NASAA Appoints Edgar Committee	August 29, 1984
Open Commission meeting on Edgar	August 30, 1984
Release Requesting Public Comments on Operational Edgar Financing	September 5, 1984
Open Commission Meeting on Edgar	October 25, 1984
Open Commission Meeting on Edgar	January 18, 1985
Conference with NASAA	March 20, 1985
Survey of Pilot Participants and Financial Printers Requesting Information on Edgar Experience	April 17, 1985
SEC Staff Conference with NASAA Edgar Committee	April 26, 1985

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Release Requesting Public Comment on Edgar Temporary Rules for Public Utility Holding Companies	May 23, 1985
Release of Pre-Solicitation Document ("PSD") and Executive Summary for Comment	July 1, 1985
Open Meeting with Potential Bidders to Discuss PSD	July 23, 1985
Conference with Self-Regulatory Organizations	July 30, 1985
SEC Roundtable - Edgar a Major Agenda Item	September 5 & 11, 1985
Conference with Edgar Filers	September 12, 1985
Release Requesting Public Comment on Edgar Temporary Rules for Division of Investment Management	September 23, 1985
Conference with Securities Industry Automation Experts on the Operational Edgar System	October 2, 1985
Public Meeting on the Operational System and Summary of Changes	November 25, 1985
Open Commission Meeting on Edgar	December 10, 1985
Public Solicitation of Comments on Certain Issues Raised at the 11/25 Meeting	December 17, 1985
National Security Agency Submits Formal Report and Recommendations on Operational Edgar Security	January 4, 1986
Staff Conference with NASAA	January 6, 1986
Chairman Shad Meets with NASAA Representatives	January 16, 1986
Conference with Financial Printers	January 29, 1986
Open Commission Meeting on Edgar	January 30, 1986
Conference with NASAA on Edgar	January 31, 1986
Public Panels Discussion on Dissemination of Edgar Information	February 10, 1986
Open Commission Meeting on Edgar	February 11, 1986
Conference with NASD on Edgar	March 3, 1986
Conference with NASAA on Edgar	March 13, 1986
Conference with Information Industry Association on Edgar	March 26, 1986

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Discussion at American Bar Association Meeting	April 4, 1986
Open Commission Meeting on Edgar	May 6, 1986
Release of Request for Proposals	May 7, 1986
Pre-Proposal Conference	June 17, 1986
Release Requesting Comment on Advance Notice of Proposed Rulemaking for Operational Edgar System	June 26, 1986
Open Commission Meeting with Financial Executives Institute	July 30, 1986
Staff Conference with NASAA and American Bar Association	August 11, 1986

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Congressional Meetings, Testimony and Other Communications on Edgar

Hearing - Senate Securities Subcommittee (D'Amato)	March 25, 1983
Letter to House Government Information Subcommittee Submitting Edgar RFP Materials	February 23, 1984
Hearing - House Telecommunications Subcommittee (Wirth)	February 23, 1984
Subcommittee on Telecommunications (Wirth)	February 23, 1984
Hearing - Senate Appropriations Subcommittee (Laxalt)	March 7, 1984
Hearing - House Appropriations Subcommittee (Smith)	March 16, 1984
Notification of Congressional Staff of Pilot Contractor Selection	May 1, 1984
Edgar Referenced in House Appropriations Bill	May 23, 1984
Edgar Referenced in Senate Appropriations Bill	June 13, 1984
Edgar Referenced in Appropriations Conference Report	August 3, 1984
Letter - Srodes to Congressional Staff with Edgar Information and Offering SEC Edgar Tour	September 13, 1984
Congressional Staff Tour of Edgar (1st)	September 21, 1984
Letter from Chairman Dingell Requesting Edgar Documents	October 2, 1984
Letter to Interested Members of Congress Requesting Review and Comments on Edgar	October 11, 1984
Letter to Chairman Dingell Providing 10/2 Requested Information	October 12, 1984
Dingell Staff Reviews Edgar Documents at SEC and Interviews Staff	October, 1984
Congressional Staff Tour of Edgar (2nd)	November 16, 1984
Dingell Staff Interview SEC Edgar Staff	November 30, 1984
Letter from Chairman Dingell Requesting Additional Documents	January 7, 1985
Letter - Fogash to Chairman Dingell Providing 1/7 Requested Documents	January 18, 1985
Letter - Kiernan to Chesson (Dingell staff) Providing Additional Documents Requested in 1/7 Letter	January 31, 1985

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FY 1986 Budget Submission re Edgar	February 4, 1985
Congressional Staff Tour of Edgar (3rd)	February 15, 1985
Letter - Kiernan to Norwood (Dingell Staff) Providing Certain Edgar Documents	February 22, 1985
GAO is Requested by Chairman Dingell to Review Pilot	March 1, 1985
Hearing - House Oversight and Investigation Subcommittee (Dingell)	March 14, 1985
Hearing - House Telecommunications Subcommittee (Wirth)	March 21, 1985
Hearing - House Appropriations Subcommittee (Smith)	March 27, 1985
Hearing - Senate Securities Subcommittee (D'Amato)	April 17, 1985
Hearing - House Government Information Subcommittee (English)	April 24, 1985
Hearing - Senate Appropriations Subcommittee (Laxalt)	May, 1985
Meeting with Senate Staff	October 17, 1985
GAO Begins 2nd Review Requested by Chairman Dingell	December, 1985
Edgar: A Status Report	December 31, 1985
FY 1987 Congressional Budget Submission Includes 7-Year Appropriation Needs for Edgar	February 5, 1986
Supplemental Authorization Submitted to the Congress	February 20, 1986
Hearing - House Appropriations Subcommittee (Smith)	February 21, 1986
Hearing - House Telecommunications Subcommittee (Wirth)	March 5, 1986
Report of Committee on Government Operations, "Electronic Collection and Dissemination of Information by Federal Agencies: A Policy Overview," Containing a Discussion of Edgar	April 29, 1986
Transmittal of Edgar RFP to Interested Members of Congress and Their Staff	May 12, 1986
Edgar: A Status Report	June 30, 1986

The following are GAO's comments on the Commission's Executive Director's letter and Executive Summary dated September 15, 1986.

## GAO Comments

1. The difference between the pilot statistics in our report and those in the Commission's comments is primarily due to the time period involved and the Commission's inclusion of investment management companies that use EDGAR only for transmission purposes. We were requested to review the EDGAR project through completion of the pilot, and we provided statistics to reflect Commission experience through April 30, 1986—the expiration date for the original pilot contract. As of that date, the Commission had received 5,712 filings and there were 316 pilot filers. This total included 178 for the Corporation Finance Division and 138 for the Investment Management Division (including 15 public utilities). We did not include 263 investment companies that used EDGAR only to transmit a semi-annual report for input to another Commission computer system, not for processing and analysis by EDGAR.

2. We requested and received from the Commission copies of letters submitted by potential vendors that prompted the Commission to defer the due date for proposals from September 10, 1986 to December 31, 1986, and to consider revisions to the RFP. A discussion of the content of these letters appears on p. 46.

3. As we note in chapter 2, Commission officials stated that they did not formally obtain comments from filers on proposed filing requirements prior to RFP release. The Commission now indicates that it has obtained extensive comments and provides a list of 51 conferences and solicitations of comments. While some of these comments could provide filer perspective—such as those from pilot participants (as we acknowledge in the report) or from financial printers (who can prepare and submit filings from filers)—the Commission has apparently included various comments received on EDGAR whether or not they provide filer input on proposed filing requirements. For example, the Commission's list includes at least 11 that specifically concerned procurement issues for the pilot or operational systems, not the additional requirements of electronic filing. In addition, we obtained and reviewed minutes of six of the seven "open Commission meetings on EDGAR" shown on the list (having attended the May 6, 1986, meeting) and found no filer input on proposed EDGAR filing requirements. Still other items on the list that do not relate to filer comments include an analysis by the Federal Bureau of Investigation and a report by the National Security Agency, both relating to EDGAR security. In addition, it was difficult to determine what comments

were received in other cases because the Commission did not document the results of interactions, such as conferences with the North American Securities Administrators Association on March 13, 1986, and with the National Association of Securities Dealers on March 3, 1986. In conclusion, as we note in the report, the Commission had not attempted to obtain comments from the overall filer population on proposed EDGAR filing requirements until its June 26, 1986, release of the advance notice of proposed rulemaking. As a result, we continue to believe that while this initial step in the rulemaking process will provide some measure of comment, the overall timing of the Commission's rulemaking limits its usefulness in finalizing system requirements particularly for use in preparing the RFP.

4. In chapter 2, we note that the Commission could not consider the impact of exemptions to proposed electronic filing requirements in preparing the operational system RFP because it did not formally obtain comments from the overall filer population prior to RFP release. The Commission contends that it has designed EDGAR to accommodate virtually all filers, and that comments of pilot participants underscore the low cost and ease of use of the EDGAR system. For these reasons the Commission expects that requests for exemptions will be limited and will not materially impact the benefits of EDGAR.

To demonstrate the need for obtaining comments from the overall filer population prior to RFP release, we reviewed 88 sets of comments the Commission received in response to its advance notice of proposed rulemaking for EDGAR. These comments included those of at least 32 pilot participants, as well as other companies filing with the Commission, attorneys, and accountants. They also included other organizations representing filers or interested groups, including the American Society of Corporate Secretaries, Inc., a professional association composed principally of corporate secretaries with approximately 2,800 members representing 2,200 corporations in the United States and Canada; the Investment Company Institute, a national association of the American mutual fund industry, whose membership includes 1,660 open-end investment companies ("mutual funds"); and the Financial Analysts Federation with some 15,600 members who are securities analysts, portfolio managers, investment counselors, and funds managers. Our review showed that not all pilot participants or other organizations agree that EDGAR is low cost and easy to use, as examples below indicate.

- One pilot participant stated that it saw few benefits to registrants from the EDGAR pilot program, having had some extremely unpleasant experiences such as difficulty in transmitting a time-sensitive filing and incurring \$8,000 in additional expense to convert some previously prepared financial statements to an electronic format for transmission to EDGAR.
- Another pilot participant stated that it would probably not enter the program voluntarily if asked today because of the substantial additional costs and administrative burdens that have resulted from electronic filing.
- Still another pilot participant noted that while it generally endorses electronic filing, it is “concerned that the Commission and its Staff seriously underestimate the challenge which a mandatory shift to electronic filings presents to investment company registrants.” (Original under-scored.) This company’s conversion to EDGAR filing included creating and maintaining an electronic data base and recruiting and training additional staff.
- A national association of the American mutual fund industry commented that association members who participated in the pilot program report they incurred more than “minimal” added expense in upgrading their own system and equipment and in adding personnel to accommodate electronic filings. It also said that, *contrary to the Commission’s views, experience to date indicates that there will be more than minimal burden even if electronic filings are made through agents or service bureaus. The association notes, for example, that “...projected cost of utilizing a financial printer for filing by one of the present pilot filers is enormous—\$1 million.”*

These and other similar comments indicate that requests for exemptions may not be as limited as the Commission contends. In addition, at least 35 commenters, (or 40 percent of the 88 comments) specifically cited a need for temporary exemptions in the event of filer or Commission technical difficulties. Many of these wished to submit paper filings in such instances and later refile the document electronically when difficulties are corrected or within a specific time. As we note in the report, filings received on paper would obviously not accrue the benefits of EDGAR processing. In addition, these paper filings would not be in the EDGAR data base on a timely basis and could reduce its value for dissemination purposes.

Other filer comments on proposed changes showed that 41 of the 88, or 47 percent, oppose incorporation by reference procedures; 43, or 49 percent, oppose electronic filing of previously filed exhibits; and 29, or 33

percent, oppose providing financial data in the Commission-specified format. Such comments indicate the Commission may have difficulty imposing these requirements completely or within the timeframes it or its offerors' envision. Exempting or delaying filers from complying with the requirements would affect the extent to which the Commission achieves EDGAR benefits and the completeness of the data base for dissemination, and could result in changes to EDGAR requirements that should be reflected in the RFP.

5. We agree that the public reference rooms satisfy FOIA requirements. However, at issue is, under the User Charge Law (which the Commission calls the Independent Offices Appropriations Act), what costs should be included in the cost base for setting fees charged to subscribers wishing an entire copy of the data base (Level I) or a selected portion of the data base (Level II). Our position and that of the Commission differ on the funding of the receipt system.

In detailed comments supporting its executive summary, the Commission contends that it does not bear the costs of delivery (mail, delivery service, and so forth) under the present manual receipt system; hence it should not be required to pay for receipt processing. We do not agree with the Commission's analogy between delivery costs and the cost of the receipt system. Under EDGAR, filers will continue to pay for delivery whether as postage or delivery costs for tapes and diskettes, or telephone charges for direct transmissions. Moreover, the cost of the receipt system would not be borne by filers as delivery costs, but rather by users of filing information through fees charged by the contractor.

The Commission also believes that the receipt and dissemination of filings are interrelated and dependent, and should be operated as a single system funded by the contractor. We continue to believe that receipt is necessary for the Commission to perform its internal processing mission requirements. Before a filing is disseminated to the public, it must undergo acceptance processing by the Commission to ensure that its form is correct, filing fees have been paid, and signatures are present. With EDGAR, electronic receipt will be necessary so the Commission can perform acceptance processing, and the Commission hopes to use EDGAR to further automate the process. In addition, after acceptance, EDGAR will use automated techniques to aid in both the selective and substantive review of filings. These examples illustrate the critical nature of the receipt function to the Commission's ability to perform its mission. We do not believe that because filing information will be electronically disseminated, users should pay for development of the portion of the

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system needed to receive filings, transmit them to the Commission, store them until accepted, and provide filers with a means of determining the status of filing receipt and acceptance.

6. Our objection to the Commission's proposed funding approach was first voiced in our March 14, 1985, testimony on the initial EDGAR proposal. We have restated our concerns in this report. At no time did GAO representatives agree with the Commission's approach. Our position has always been that if the Commission provides to the public any legally required information services or voluntarily provides information dissemination services, it may not recover fees that exceed the limitations on assessing and recovering fees under existing provision of law—FOIA and the User Charge Law.

7. We agree that some government functions may be financed through means other than appropriated funds, but the financing approach must be in accordance with existing laws. In its March 12, 1985, legal decision, the Commission has cited a number of our decisions to support its conclusion that a no-cost contractor could be authorized to disseminate filing information, charge a fee for this dissemination, and retain the fee. We agree that these decisions support the position that a contractor may provide information to the public that the government would otherwise provide under FOIA or some other provision of law. However, these decisions do not support the contention that the fee charged by the contractor may exceed what the government would have otherwise collected had it performed this service directly, other than for the inclusion of a reasonable profit to the contractor.

In addition, the Commission cites a previous decision regarding the right of persons providing stenographic and reporting services to the government to finance the providing of these services to the government at no cost by selling copies of their transcripts to the public and retaining the proceeds from these sales. However, this decision was rendered prior to the adoption of FOIA and the User Charge Law that set limitations on costs recoverable by agencies when providing information or special services to the public. Subsequent to this decision, section 11 of the Federal Advisory Committee Act (86 U.S.C. §775) was specifically adopted to limit fee recovery by individuals providing stenographic or other reporting services.

8. To show that there has been congressional oversight, the Commission provides a list of 36 congressional meetings, testimony, reports, and other communications. We were aware of many of the items on this list,

particularly those since our initial review of EDGAR in March 1985. We do not dispute that the Commission has included EDGAR funding in its budget submissions and consulted with and provided requested information to the Congress on the EDGAR program. However, we continue to believe that the Commission's proposed funding approach reduces the Congress' oversight role because the Commission's appropriation requests would include only the amount needed to fund what it has identified as its internal system, not the cost the contractor would incur to enable the Commission to perform its internal functions, including the receipt of filing data. These appropriation requests would also be for fixed amounts, not actual contractor expenditures.

Information on the actual cost of the internal system is critical to oversight of the EDGAR program. For example, information on actual costs incurred by the contractor could indicate the ability of the contractor to successfully complete EDGAR development. The Commission's own cost analysis estimated that the contractor would incur some \$15.6 million in the first year for internal system equipment and operating expenses as compared to the \$5 million contributed by the Commission. Further, as we discuss in this report, we believe the Commission has underestimated the internal system's cost. As a result, costs exceeding the Commission's contribution could conceivably jeopardize contract performance. As another example, although the Congress would appropriate annual amounts, a decision could be made by the Commission or the Congress not to continue the EDGAR program after the initial contract award. Such a decision could make the government liable for termination costs that could include the costs incurred by the contractor up to the termination.

9. The Commission introduces its comments on our review of EDGAR cost/benefit analysis by stating that investors, issuers, and the economy will be the principal beneficiaries of EDGAR and by listing potential benefits they will receive. As we stated previously, given the Commission's recognition that internal system costs far outweigh quantifiable internal benefits, the Commission's decision to proceed with EDGAR rests solely upon the belief that sufficient "external" benefits will accrue to these beneficiaries. Because of the essential nature of these benefits to justifying EDGAR, the Commission's analysis must clearly and objectively describe these benefits and how and to whom they will accrue. For example, the Commission illustrates that EDGAR filers can take advantage of "market windows," make changes up until the instant of filing, and file on a same-day basis from the West Coast. However, in describing these benefits, it is appropriate to recognize that such savings can be had only by those filing by direct transmission, and not by those

mailing or delivering tapes and diskettes, which, during the March 1986 peak filing period, amounted to about 17 percent of the pilot participants.

10. During our review, we noted the \$3.2-million contingency reserve included in the Commission's proposed \$35-million funding amount for the contract; we discussed this reserve with a Commission official. In reviewing the Commission's cost estimate for the operational EDGAR system, we found detailed documentation for estimates of internal system hardware costs, but no documentation for cost estimates of developing and operating the internal system. Without this documentation, we were unable to determine the reasonableness of assumptions the Commission used to estimate costs. This is particularly important since the Commission developed its estimates in August 1985, about 8 months before completion of the EDGAR pilot and release of the operational system RFP when system requirements were better known. In addition, our analysis showed that hardware costs could exceed Commission estimates by millions of dollars (currently by as much as \$4.4 million), which would more than exceed the Commission's contingency reserve. For these reasons, we did not specifically address the contingency reserve in our discussion of Commission cost estimates.

11. The Commission refers to a model developed by its Office of Internal Audit to show the potential impact of artificial intelligence—a \$4.9-million increase in benefits for each 10 percent increase in filings processed per year. Such increases in filings processed would be in addition to savings already considered in estimating quantifiable internal benefits. However, artificial intelligence is not currently a requirement for the operational system and the Commission considers it technologically immature at this time. Other than artificial intelligence, the Commission could not provide an acceptable rationale on what would cause a further increase in benefits as indicated by the model. In addition, if the Commission ultimately includes artificial intelligence in the operational EDGAR system, then its additional cost should also be recognized in conjunction with any additional benefits.

12. In the draft report, we used the fiscal year 1986 General Services Administration schedule prices for IBM equipment. Aware that prices were reduced for certain models subsequent to this contract, we contacted IBM to obtain the most current pricing information available. Revised prices now included in chapter 4 of our report show that the purchase price of the IBM 3090-200 is currently \$4.1 million or \$0.6 million more than the \$3.5 million included in the Commission's hardware

cost estimate (a purchase price of \$4.6 million and a difference of \$1.1 million was shown in our draft report). Revised prices also show that an upgrade to a 3090-400 is an additional \$3.8 million as compared to the \$4.1 million previously indicated. Price differences for the 3090-200 and the upgrade to the 3090-400 now total \$4.4 million more than was included in the Commission's cost estimate as compared to \$5.3 million more we originally indicated.

The Commission states that the \$1.1-million cost difference originally indicated is well within the \$35-million fixed cost contract and that ongoing hardware and software enhancements will allow it to meet the projected increased processing needs without an upgrade. However, we believe the Commission must consider the total \$4.4-million potential cost increase, which exceeds even the Commission's \$3.2-million "contingency reserve" contained in its cost estimate of the internal system.

To support its contention that an upgrade will not be needed, the Commission also notes that there has been a long-term trend of declining mainframe costs resulting from increasing competition and ongoing technological improvements. While we agree that hardware costs are declining, we do not believe this justifies the Commission's position that no additional costs will be incurred to meet the increased processing needs clearly indicated by the model. The Commission does not dispute that, based on pilot experience and projections for the operational system environment, the IBM model shows EDGAR internal processing needs will reach 90 percent of the 3090-200's capacity by as early as 1988. We believe that there will be some costs involved for whatever measures the Commission takes to meet these increased internal processing needs, and the cost of the indicated hardware upgrade is one means of estimating such costs.

13. As the Commission notes, the RFP does require the contractor to provide 10 development staff years per year. But, as stated in the RFP and specifically explained to offerors, these staff years are to be used for system enhancements, not development of the operational system requirements shown in the RFP. Our concern involves the development cost for known requirements, for which these additional development staff years are not to be used. Moreover, in comments provided the Commission prior to its June 1986, preproposal conference, at least one potential offeror estimated the cost of providing such staff at \$1 million per year. Such an amount reduces the sum the contractor receives to actually develop the internal system requirements contained in the RFP.





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